

Challenge

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from the editor

a personal note

■ THE HUMAN PENDANT for surprises is, I suppose, responsible for how often we are caught unprepared by developments that were obvious for some time. For example, puzzlement and even dismay were common reactions to the news that the United States was experiencing an adverse balance in international payments—and in sizable amounts. As far as the public knew, everything was all right until December, 1959. How could the roof cave in so suddenly?

Obviously, it took longer than one month to pile up a \$4-billion deficit. In looking at the record of previous months, then, we saw that gold and dollar losses had occurred all through 1959. And there was a \$3.4-billion deficit in 1958. The signs of these developments were apparent by the last quarter of 1957. Still, the news of our imbalance in international payments did not hit home until two months ago.

The reaction was appropriate to the unpleasantness of the surprise. Would there be a flight from the U.S. dollar? Would Fort Knox become an empty vault? Would the country slip to the status of a second-class power? What had gone wrong?

These questions, and many related ones, have been appropriately answered in this issue of CHALLENGE. The U.S. is not on the brink of bankruptcy. The dollar will not be devalued. Uncle Sam will not suddenly

be reduced to a debtor. We shall not lose all our gold. What has happened, and still is happening, does not represent a real crisis. But we should heed the warning. No more surprises, please.

Probably the most appropriate question we can ask ourselves is: What is at stake? What does it mean to a prosperous and vigorous American society to have the dollar decline in value abroad? What would we lose if we should cease to do business with those areas that are piling up the largest claims against us?

The official Washington attitude toward these problems seems to me to be eminently sensible. No one is advocating an abandonment of the foreign aid program. No responsible party is advocating an across-the-board dismissal of the free trade idea. The economic revival of Europe is accepted as the fulfillment of the wishes of American policy. The new policy of the Development Loan Fund can hardly be termed a violent reaction. By this inducement the underdeveloped countries must buy the more expensive goods of the United States, but the government cannot be held solely responsible for the prevailing price level.

Part and parcel

Ever since the pronouncement of the Marshall Plan in 1947, American policy has been to bolster the economy of the free world. The transfusion of American resources into the economic veins of nations abroad has probably altered the course of world history. The European Common Market idea, with its promise of eventual political integration as well, was part and parcel of the American hope for a strong European continent. Now that the Soviet Union has

begun to flex its economic muscles, the wisdom of the American policy becomes dramatically evident.

The argument that the European countries are now in a position to eliminate their system of quotas and discriminations against American goods is well taken. The free world must sooner or later learn to trade freely, or cease to be an effective working bloc. This means that the American economy will be burdened with competition from friends. But how can we ask for less and remain respectable? In any case, we need the rest of the free world, and they need the United States. In seeking to cope with the present deficit in our international exchanges the American government followed the only possible course. It has been a pragmatic and wise course.

The popular attitude

Quite apart from the attitude of official Washington there is, of course, the popular attitude to be considered. The public has two faces. One face belongs to the man in the street, the individual who harbors a personal opinion. The other face belongs to a group or constituency, the collective will that exerts pressure to safeguard a special interest. Both faces have a stake in the changing role of the United States in the world economy.

The reaction of the individual may perhaps be that of wounded pride. Americans do not like to fall behind in anything, and a payments deficit looks very much like we are falling behind. Can it be that those we have fed have now turned to bite us? Can it be that those we have supported will end up living better than we, ourselves, are able to live?

The group responses are defensive.

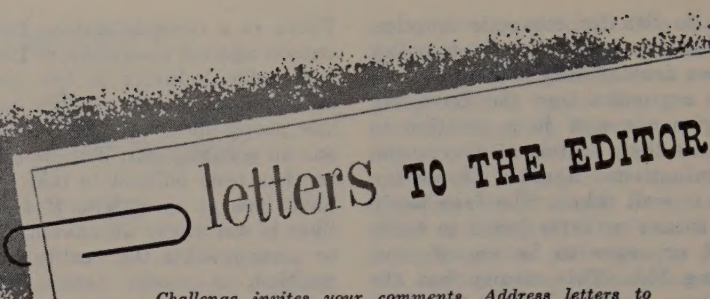
There is a common outcry for protection against cheap labor. The fishing tackle industry in this country has its back to the wall. The automobile people have been forced to turn out an economy car. The steel industry has been obliged to take a long, hard look at its prices. But no one likes to surrender an advantage just to accommodate the reality of competition.

Europe has become a competitor—a worthy one. However, her wage rates are moving up also. Soon they may catch up with ours. Perhaps in time the zeal of rebuilding will wane, and she will get soft and comfortable. But until that time comes, what new peaks of economic achievement will the Europeans attain? Will they be so far out of reach by then that U.S. prices will be hopelessly outclassed?

A positive response

The real problem is not that the European economy has revived. Nor is the problem the proliferation of competitors from areas now underdeveloped. The simple fact is that the American economy must come to grips with something that it has not had to contend with for a long time—price competition. A positive response to this challenge would be as welcome at home as it would be helpful to our situation abroad.

The economic revival of Europe has brought into being that much-discussed and much-desired “third force” which now stands between the U.S. and the Soviet Union. It is not much of a military force, but it needn't be in the existing stalemate. The poverty-stricken vacuum is no more. Europe is once again the master of her own destiny. All the United States has to do now is to put her own house in order.—H. B.



letters TO THE EDITOR

Challenge invites your comments. Address letters to
CHALLENGE, 475 Fifth Avenue, New York 17, N. Y.

Ethics—forgotten factor

• Wilbert Moore in "Affluence, Softness and Growth" [December, 1959], has presented a somewhat one-sided picture of the value of money and materialism by failing to mention the ethical and spiritual aspirations of men.

Poverty in any form is, without question, paralyzing. But surefeith and prosperity also can paralyze the progress of a nation. Certainly, making money to buy the material comforts that we want is not the ultimate purpose in life. No rational man will say that it is.

The trouble is that in their quest for material comforts, men forget that they need a purpose to guide them fulfilling through life. When they forget this their character does soften. How else can we explain the increasing divorce and juvenile delinquency rates, the easy brainwashing of our soldiers, widespread nonconcern with political and voting obligations and lack of a sense of individual responsibility for what is happening to people in other lands?

In a nation where purpose is absent among its people, communism (which does have a purpose and dedication) will find fertile minds to work with. Can we honestly argue

that preoccupation with personal and national economic growth and affluence is to be preferred to preoccupation with purpose of an ethical and spiritual nature?

E. F. DUMAS

Pittsburgh, Pa.

Farm remedy

• I appreciate your review of my book, *The Great Farm Problem* [Reading Report, December, 1959]. However, in the presentation of my recommendations to end the farm mess, your reviewer mentioned only my proposal that government farm inventories and contingent liabilities be sold back gradually to farmers and farm groups. He left out the heart of my suggested remedy, viz.: "Progressively work down all price supports and guarantees, as well as all acreage and marketing controls, at the end of current contracts, and then discontinue."

WILLIAM H. PETERSON
New York University

New York, N.Y.

Reflections on waste

• I have read "Featherbedding—the Economics of Waste" in the November issue of CHALLENGE. Prof. Backman, by carrying the thought fur-

ther, could mention that if you don't throw waste paper on floors or in public parks, you could, conceivably, contribute to putting a man out of work. The dilemma presented may be continued: if advertisers do not send bulk mail, the post office department might have to lay off men, the trash collectors might be affected, not to mention the printers, paper manufacturers, etc. There is a lot to think about.

LLOYD W. CLARK

Phoenix, Ariz.

Challenging thoughts

- The writers in CHALLENGE, specialists as they are in their various fields, are thought-provoking, but their articles—alas!—give rise to unanswered questions.

In the November *Interview*, Harrison Brown makes the interesting assertion that one ton of granite contains energy equivalent to 50 tons of coal; a few clarifying words are indicated. How, in general terms, are we to get at this energy?

"Peterson's Law" [November, 1959] is another case in point. Is the volume of complaint against increasing inflation a cause of inflation? It is hardly likely that it is more than evidence of events to come.

CHALLENGE offers challenges, all right.

WILLIAM P. RICHARDS

San Diego, Calif.

Status quo?

- Your discussion of genetics and the "average man" with Prof. Dobzhansky [December, 1959] dispelled any doubts about geneticists which I might have acquired by reading Huxley's *Brave New World*. They (the

geneticists) are not, then, in favor of creating an "adjusted man" for every job, climate and location. The job of redesigning the world's population *would* be a little overwhelming. However, Prof. Dobzhansky presents a problem of developing educational systems and environmental situations to fit individual needs that is not much easier to solve. If we are to find environments that will encourage optimal development of each individual we may eventually find it necessary to admit that the child of a California vegetable grower "belongs" to a couple in Chicago and that the California parents should be consoled with the son of a New York lawyer. Encouraging optimal development by putting each individual in the "right" environment could be as unnatural as Huxley's "bottled babies."

HARRY GEDMAN

Ft. Lauderdale, Fla.

Encouraging investment

- Mr. Dobrovolsky courageously advocates tax advantages that would encourage investors to put capital into small firms which cannot themselves retain enough earnings to expand. ["How Much Investment for Growth?," December, 1959]. At a time when there has been considerable talk that Congress may withdraw even the tiny \$50 tax exemption on dividend income, the trend would seem to be in the other direction. Dobrovolsky states the cause well—but I wonder how many people in Washington will read his article.

GEORGE LADETO

Cambridge, Mass.

Many!—Ed.



Challenge Notes

What the steel settlement left unsettled; fringes and collective bargaining;
the limits of industrial heroism; making conversation with machines

■ THE SETTLEMENT of the steel strike seems to presage a spring largely free of serious labor strife. Most labor experts predict that the railroads, the only major industry that will be bargaining this spring, will settle with the Brotherhoods without a strike. Congressmen, who would prefer to talk of other matters in a pre-election year, will be spared the painful necessity of antagonizing powerful segments of the electorate. The sigh of relief around Washington could be heard in Los Angeles.

But the relief, while quick and fast like aspirin, will be similarly short-lived. For, what did the settlement really settle? The work rules issue, has been neatly sidestepped. But it will surely reappear, and neither management rhetoric about "prerogatives" nor union accusations of "labor slavery" will absolve future management and union bargaining teams from the

necessity of doing something about featherbedding practices that are undermining our competitive position overseas.

Nor has the steel settlement solved the more basic problem of protecting innocent third parties against the social and economic costs of strikes in crucial industries—Pittsburgh store keepers, automobile workers, steel consumers, and so on. At present, the interest of such innocent third parties, whose number greatly exceeds the contract beneficiaries, are nowhere represented. In such a context, how *collective* is collective bargaining? This is another important problem that the steel settlement does not settle, as most of us will find out when the expected steel price increases go into effect.

Fringe costs

One aspect of labor agreements in recent years has been the

growth of fringe benefits—such things as pensions, medical programs, paid sick leaves, and so on. In the past 10 years, such non-wage extras have risen more than twice as fast as wage rates.

That union bargaining policy has placed increasing emphasis on fringe benefits is shown by the fact that such fringes have risen fastest in the more organized industries.

The trouble with this strategy is that, under industry-wide bargaining, such benefits will affect different companies quite unequally. For example, a company with a large proportion of workers enjoying high seniority will be more immediately affected by an increase in pensions than a new firm with relatively few seniority workers. An industry-wide increase would, therefore, cost some companies much more than others. Whatever the merits of industry-wide bargaining in the area of wages, it may prove increasingly unworkable in the case of fringe benefits.

A new romance?

The recent announcement by the Soviet government that it is going to revise its formula for bonuses to reward workers who drive down production costs rather than those who merely increase output makes interesting reading. For more than three decades, the Soviet Union has been so obsessed with the need

to expand production that all the rewards of the system went to the man or woman who overfulfilled their production quotas. The romantic tribulations of competing tractor drivers (male and female) have been a staple of Soviet film romance. Now, all this will be changed. The new "heroes of Soviet labor" will have to produce more with less. But outside of Soviet films, we doubt that Soviet workers will be any more heroic than their American counterparts when it comes to eliminating their own contribution to labor costs.

Machine talk

Machines, according to a recent report by the American Association for the Advancement of Science, have been taught to make "spontaneous" conversation about the weather. The only way in which your chat with a 650 IBM computer will differ from the usual weather remarks you exchange with your neighbor is that the machine will not allow you to deceive it.

If you tell the machine it is a cloudy day, you had better stick to your story. Otherwise, the machine will get quite indignant. When a man last tried to trick the machine, he got the following answer: How can overcast skies and the clear day you mention coexist?

Only a human mind could answer that one.—M. K.

the Dollar Shortage

For all practical purposes, the dollar shortage is over, and the U.S. will have to adjust to this fact of international life

by Roy L. Reiersen

■ THE OUTLOOK for the price of gold and the situation of the U.S. dollar, two closely related topics of recent interest in the United States, have been under recurrent discussion abroad for a decade and more.

Questions of this kind evoke keener and much more persistent interest in foreign financial centers than in the United States. In European financial markets any story on gold and the dollar is followed avidly.

Concern over the dollar apparently reached a peak in the spring of 1958, when the business recession in the United States, the prospect of a huge federal deficit, and a large outflow of gold all led to a rash of questioning and uncertainty. Many people then contended that the United States might find it necessary to devalue the dollar

as a result. At present, few informed observers hold any change in the relationship of the dollar to gold to be imminent.

This, however, does not mean that foreign observers have relaxed their scrutiny of economic, financial and political developments that seem to be keeping inflationary pressures alive. Financial circles abroad are concerned with the inflation problem in this country primarily because of the effects on the United States balance of international payments. At present, American industry runs the risk of pricing itself out of the world market. Simultaneously, imports have soared while exports have declined. Thus, it is considered likely that the adverse balance of payments position of the United States may continue for some time

and that this will continue to drain the United States gold stock.

Some observers fear that at some point the United States will become concerned over the persistent loss of gold and the authorities will have to impose an embargo on gold. This, in effect, would lead to a sharp rise in the gold price at home and abroad.

A more substantial body of opinion, however, stresses that U.S. government officials of both political parties are firmly on record as opposing a change in the gold price and that the United States cannot, in the foreseeable future, be pressed into a position where it must devalue against its will. Despite a gold outflow of about \$3 billion in the past one and one-half years and the recent payment of a gold subscription of \$344 million to the International Monetary Fund, the United States gold reserve is still huge, comprising close to one-half of the monetary gold stocks of the free world.

The United States is thus in a position to withstand a gold outflow of \$1 to \$2 billion a year for some time to come. In addition, the gold reserve coverage of Federal Reserve deposit and note liabilities, currently at about 40 per cent, still exceeds the statutory requirement of 25 per cent by a sizable margin. Moreover, in the event of sustained pressure, the statutory requirement could well be lowered without

unsettling the financial system. Finally, in the event of emergency, there is a further bulwark in the resources of the international financial institutions, especially those of the International Monetary Fund.

In any event, few Europeans expect the United States to devalue the dollar unilaterally as a means of bringing the domestic price level in line with world markets. The more prevalent belief is that inflationary tendencies and an increasingly troublesome balance of payments problem will make the United States amenable to an increase in the price of gold *in which other leading countries would join*. In effect, this would be a currency devaluation on an international or practically world-wide scale, leaving the exchange relationships between the dollar and other key currencies substantially unaltered.

Against this background of conflicting views and forecasts, it is essential to retain perspective and seek a balanced, realistic appraisal of the current standing of the United States dollar.

There is little evidence of any widespread loss of confidence in the dollar. Even in 1958, when American gold losses were running at an exceptionally rapid rate, foreign holdings of short-term dollar assets increased by over \$1 billion. In 1959, despite a further, albeit slower, gold outflow, at least an-

other \$1 billion was added to these assets, which now aggregate some \$16 billion. Both the size of these holdings and their upward trend suggest no real apprehension abroad that a change in the American gold price is at hand.

European observers have said that perhaps the greatest risk in the current situation is a loss of confidence in the dollar on the part of Americans themselves. This would no doubt be accompanied by a large-scale movement out of the dollar into gold or foreign currencies and securities. So far, however, there is no sign that any such movement is in the offing. To be sure, American interest in foreign equities has increased considerably in recent years. But this is not due to distrust of the dollar. Rather, the motivating forces are the attractive growth prospects of the European economies and the equally attractive investment values available in Europe.

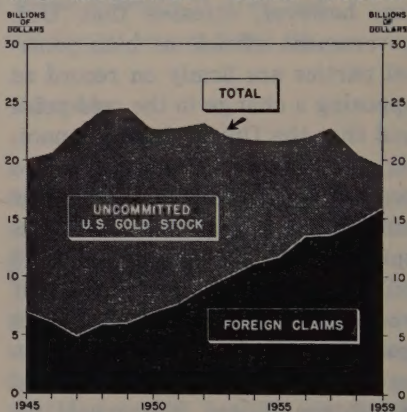
Striking progress

While these considerations may help retain perspective, it cannot be denied that the record of the United States in recent years does not compare favorably with that of some other major countries. Most of the European countries have made striking progress toward monetary stability and have moved successfully toward containing inflationary tendencies. Unless we

face up to our situation in the same earnest fashion as our friends abroad have faced theirs, we shall be incurring the risk of sliding into more serious difficulties as time moves on.

In the early postwar era, economic weakness abroad made the dollar appear strong regardless of

U.S. MONETARY GOLD STOCK



SOURCE: FEDERAL RESERVE BULLETIN

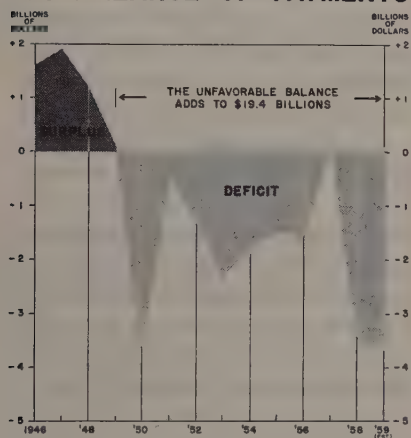
Graphs courtesy of "TRC Tradeways"

the policies we followed at home. Today, however, United States economic policy must be based on the assumption that the major countries of Western Europe will continue along the path that has proved so successful in restoring the health of their currencies in recent years.

The outflow of funds into large government grants, loans and expenditures abroad, and the sustained movement of American dol-

lars into foreign investment, were offset for many years by a large export surplus. Now, however, the export surplus has dwindled, and American industry faces increasing competition from foreign producers who are equipped with modern plants and enjoying substantial advantages in labor costs.

U.S. BALANCE OF PAYMENTS



SOURCE: DEPT. OF COMMERCE

Assuredly, U.S. gold resources are still tremendous and further losses need not be a matter of serious concern, either to foreign creditors or to Americans, provided we take appropriate action to redress our balance of payments situation. At the same time, as bankers to the free world, we cannot ignore the point of view of our political and economic partners, who are holders of dollar assets. They have a large stake—economic and political, as

well as financial—in the soundness of the dollar.

In essence, the task is to keep stable the purchasing power of our currency. This means a fiscal policy which will achieve substantial budget surpluses in periods of active business to offset the large budget deficits that inevitably appear during economic declines. Equally important is that Treasury debt management be so conducted as to avoid the inflationary increase in liquidity resulting from a progressive shortening and modernization of the debt. The exact opposite of this policy is now imposed on the Treasury as a consequence of the refusal of Congress to raise the interest rate ceiling on new bond issues. Other major essentials are wage practices designed to restrain perpetual increases in production costs and pricing policies that will pass on to consumers part of the benefits of rising productivity. In this fashion, we shall not only be fortifying our prospects for sustained economic expansion at home, but shall also be enhancing our competitive ability in world markets.

Changed situation

In our international economic policies, too, we shall need to take cognizance of the changed situation regarding our balance of payments. We must urge fewer foreign trade restrictions and, at the same time,

be on guard against pressures already building up to erect greater trade barriers here at home. If we in the United States try to cope with foreign competition by quotas, higher tariffs, informal arrangements and other restrictive practices, we shall not only be raising the cost of goods to the consumer but also encouraging a renewed trend toward trade restraints on a world-wide scale. In the end, this will do us considerably more harm than good.

It is also essential that we re-appraise our policies of government loans and grants to foreign countries. In the light of our current balance of payments, ambitious plans for increased foreign aid are unrealistic. Likewise, the time has come to re-examine our governmental policies with respect to encouraging private investment

abroad. Increased investments add to the strain on the balance of payments at the time the transfers are being made. Moreover, if the investment consists of establishing productive facilities abroad, further inroads will be made upon our already meager export surplus once these facilities come into production.

Unfortunately, there are few signs as yet that we are giving these problems the attention they deserve. Having enjoyed a comfortable foreign trade position for a great many years, it is perhaps understandable that we are reluctant to adapt to a less favorable environment. The discipline of the balance of payments may have to become much more stringent before we agree to accept the implications of the current state of affairs in the world economy. ■

No Wait for the Future

INVENTORS have not waited for the 1960s to introduce items for the future. Among the patents granted in 1959, the following items should be available in the early 1960s:

- A two-way television communications system that allows both parties to see, as well as hear, each other during a telephone conversation.
- An inflatable airplane, complete with a two-cylinder, 40-horsepower engine, that is neatly packaged to be dropped to pilots downed behind enemy lines.
- An eraser attachment that can be incorporated into the mechanism of any typewriter.
- A device that can substitute for the vocal cords of persons who have undergone surgery for the removal of the larynx.
- A foam solution that can be sprayed over delicate fruit trees and shrubbery to protect them from frost damage.



THE PAYMENTS DEFICIT

New factors justify concern over the U.S.
position in the world economy

by William A. Dymsha

■ DURING THE LAST YEAR there has been growing concern about the deficit in the United States balance of payments in the world trade picture and the impairment of the dollar as an international currency. This situation is in sharp contrast to the situation that existed a few years ago—as late as 1957, in fact—when there was widespread discussion of the “dollar shortage.” Many distinguished economists maintained that the “dollar shortage” was a long-term and permanent phenomenon. Apparently, they were mistaken. Now we are having difficulty earning sufficient foreign currencies to pay for our imports of goods and services, make international investments, and finance foreign aid and

American military expenditures overseas.

Attention was called to the change in our payments situation when our surplus in 1957 became a sharp deficit in 1958—a deficit which has continued through 1959 and has been accompanied by a significant outflow of gold.

While deficits in the United States balance of payments are not new in the postwar years, there are some new factors that cause concern. The main item of concern is the size of the deficit, which has increased from an average of \$1.5 billion annually in the years 1950-56 to \$3.4 billion in 1958. During the first half of 1959, the deficit was running at the annual rate of \$4 billion. It seems to be increasing

at a steady rate, along with the outflow of gold. The total outflow of gold in 1958 and during the first half of 1959 amounted to about \$3 billion. United States gold stocks dropped to under \$20 billion in 1959.

Mutual influences

It is easy and tempting to attribute our payments deficit to single factors such as inflation, foreign aid and United States military expenditures overseas. But no such single explanation can fully explain the increasing deficit position of the United States. It is also inaccurate to say that a change in one item in the balance of payments has brought about the deficit, for all items are interdependent and mutually influence each other.

With respect to inflation, it is *relative* inflation that is important—that is, the degree of inflation in the United States compared to that in other countries. How do the prices of specific American goods and services compare with the prices of competitive foreign goods and services? In many ways, since 1950, we have done better than most countries in keeping down prices. West Germany is a notable exception. At any rate, while inflation has been a factor in our payments deficit, it does not by any means tell the whole story.

Neither do our programs of foreign aid and overseas military ex-

penditures tell the whole story—though they may contribute significant chapters. To be sure, both foreign aid and military expenses have increased somewhat since 1955-56, but not so much as other important items in the balance of payments. Besides, we must consider that foreign assistance finances substantial American ex-

If we are to pinpoint the factors that account the most for the increased payments deficit, we must focus attention on our declining trade balance and, to a lesser extent, on increased investments overseas. Our merchandise exports have long exceeded our imports. This was especially true during the postwar period. The peak was reached in 1947, when our exports exceeded our imports by about \$10 billion. Since 1947, however—especially during the last few years—our imports have been rising rapidly. Meanwhile, since 1957, our exports have been declining. As a result, during the first six months of 1959 our imports practically equalled our exports.

The increase in private foreign investments has been an important development during the last few years. Foreign investments have boomed since 1955, reaching a peak in 1957. Although they declined somewhat in 1958 and 1959 from this peak level, foreign investments in the year ending June 30, 1959,

were still running about \$1 billion above the 1954 and 1955 levels. Foreign investments represent a widening of the international economic environment, stimulating exports of capital equipment initially and, later on, encouraging imports or replacing exports. Many foreign investments have been made to provide raw materials for American industry. The trend, however, is for American companies to establish plants in foreign countries to manufacture for the markets in these countries instead of exporting to them. Subsidiaries of American manufacturers are even competing against parent companies in the American market.

Threat to the dollar?

Is the continuing payments deficit a threat to the dollar? Those who believe that the dollar is threatened by the payments deficit point out that our gold holdings have dropped to under \$20 billion, while our dollar liabilities to foreign governments and banks exceed \$18 billion. Moreover, about \$12 billion of our gold is required to cover our money in circulation. However, according to criteria used by the International Monetary Fund, a country's international reserves are considered in terms of its total holding of gold and foreign exchange, rather than in terms of net balances. We still hold over half of the world's stock of gold

and our position is much stronger than that of other countries.

The main problem is a matter of confidence in the dollar. If foreign countries lose confidence in the dollar, they will convert their dollar holdings into gold, and there will be a run on gold. There are good reasons for believing that the existing payments deficit of about \$4 billion is too large. Even a country as strong as the United States cannot sustain such a large deficit indefinitely. If it continues it will lead to continued outflows of gold and impaired confidence in the dollar. Therefore, it is important that the deficit be reduced.

How can the payments deficit be reduced? It should be remembered that *private* international trade transactions are far more important in determining our international payments than *government* transactions. In the past, our international trade and payments have shown a good capacity to adjust to changes in the world economy. Deficits tend to be self-correcting, just as surpluses are.

An immediate measure of correction in the present situation may be to offer higher interest rates as a return for investment of foreign funds. The settlement of the steel strike would also help to increase exports and reduce imports. As a long-term measure, American business firms must push exports more effectively. Industrial development

of new innovations will undoubtedly be the basis for this push. Another measure is to step up competition with imports. This is already being done, as in the case of the small automobile. Domestic production of this item will no doubt sharply curtail imports of foreign cars.

Situations overseas may also help to balance our international payments. With full employment economies and high levels of consumption and exports, pressures are increasing on wages and costs in Western Europe and Japan. Also, in view of the boom in investments overseas during the last few years, income on foreign investments should increase. Finally, we can expect interest and loan repayments to increase on loans our government has made since World War II. All this may take time, but we should expect such adjustments to occur.

In the interim what can the U.S. government do to reduce the payments deficit? The Administration has already required that Development Loan Fund (DLF) loans and some other foreign aid be used to finance American exports. It is also considering cutting foreign aid and military expenditures overseas. And it is trying to redistribute the burdens of military and aid programs among the Western European countries and Japan.

The effectiveness of these meas-

ures in reducing the payments deficit is questionable. Besides, they present many problems as far as our foreign policy is concerned. Tying Development Loan Fund loans to our exports has already led to considerable controversy within the government and outside. For one thing, this action can have only a small impact in stimulating exports, and that impact will not be felt for another one or two years. Moreover, tied loans go against past American policy of encouraging freer and expanded multilateral trade. They also make our foreign aid less effective by provoking unfavorable repercussions abroad.

Security and policy

Cutting foreign aid would have less effect upon reducing the payments deficit than commonly believed. About 80 per cent of our military and economic foreign aid has been utilized in recent years for the purchase of American goods and services. Cuts in foreign aid would, therefore, also lead to declines in exports. And cuts in military expenditures involve important considerations of national security and foreign policy. However, our efforts to get Western European countries and Japan to assume more foreign aid and common military costs are worth pursuing, despite the difficult problems of international negotiation involved.

There are other steps we can take. On the domestic level we need to continue our efforts to limit inflation. In the growing competitive international environment, we cannot afford to have our prices rise more rapidly than those of our principal competitors. On the international level, we must try to get foreign countries to reduce their trade barriers and discriminatory restrictions against our exports. The British, French and other countries have recently reduced discriminatory restrictions against dollar goods, but important restrictions still remain. However, we cannot expect foreign countries to continue to remove their trade restrictions if we follow protective policies ourselves. This is an unusually good time to push for reductions in trade barriers and expansion of world trade.

We must keep in mind that the change in our international payments position is partly caused by

normal and happy postwar developments. Our postwar policies were highly successful in encouraging reconstruction and rapid economic growth in Western Europe and Japan.

As a result of this economic growth, important progress has been made during the last year in the re-establishment of currency convertibility and the reduction of discriminatory trade restrictions. We must remember, too, that some aspects of our payments deficit may be temporary. Just as the "dollar shortage" has ended, so we can expect the payments deficit to change. The Administration should not overreact to the problem and sacrifice our achievements in foreign economic policy. We are entering a new phase of international trade in which we can expect a much higher degree of international competition. This period presents many opportunities as well as challenges for American business. ■

Two Talkative States

THERE ARE more telephones in the U.S. than in the rest of the world combined. Our two newest states, Alaska and Hawaii, use the telephone more than any other area in the world. Hawaiians and Alaskans make an average of 609 and 536 telephone calls per person a year respectively, while citizens of other U.S. states average only 472 calls per year. American telephone users now can call 130 other countries or areas and can be connected with nearly 98 per cent of all telephones in the world. Persons who dream of a land where a busy signal is never heard might establish residence in the Maldiv Islands, Yemen, Pitcairn Island or the Aden Protectorate—where there are no telephones at all.

HOW CAN THE U.S. COMPETE?



Because of its high-cost economy, the U.S. must increase research expenditures to achieve greater productivity gains

by Gerald L. Steibel

■ HAVING SUCCEEDED with rare effectiveness in deploying its economic powers to rescue a shaken world, the United States must now face the question: Can it survive its own success?

Of the reality of the challenge there is no doubt. The deficit of \$3.4 billion in our balance of payments in 1958 promises to exceed \$4 billion in 1959. This makes it clear that we had better act while there is yet time. It is just as clear that expedients such as compelling Development Loan Fund recipients to "buy American" evade the real question, which is: Why do these nations go elsewhere to spend their dollars? The real problem goes to the root of our values and practices.

The problem was described succinctly by the Swiss journal, *Neue Zuercher Zeitung*, which pointed out recently that three factors have played a leading role:

- Capital exports by both government and private investors to rehabilitate industries abroad have drained dollars and gold at a fast rate. Since 1957, the Development Loan Fund alone has paid out or committed almost \$1 billion in "soft" loans. Add the \$3.4 billion yearly for U.S. troop maintenance overseas and other expenditures which take dollars away permanently and the size of the drain becomes impressive.

- The economies of other countries, friend and foe alike, have now attained a degree of health

where they have not only receded as customers but have become competitors. Japan and Germany are foremost here, but the inroads of the Communist bloc nations cannot be ignored.

•Our production costs have been rising at home and have, in many cases, helped price us out of markets. For example, as Columbia University Prof. Seymour Melman pointed out in a paper for the Joint Economic Committee of Congress, the Russians now spend 200 man-hours to produce one 16-inch lathe every 15 minutes, whereas the United States uses 600 to 800 man-hours for the same result. The consequence shows up in a product which sells for \$3,500 in the Soviet Union, as compared with \$3,800 in Western Europe and \$10,000 in the United States. The appeal to the customer is well-nigh irresistible.

What the Communists are doing goes far beyond prices. Not only are they pushing their production costs down within their individual countries, but their Committee for Economic Mutual Assistance (CEMA) is effectively coordinating the apportionment of labor, material, resources, production assignments and transport and supply within the bloc. Long dormant, CEMA was brought to life again about two years ago and has become a principal instrument in the kind of competitive coexistence which Nikita Khrushchev has been

openly espousing but which many of his hearers are reluctant to take seriously as a threat. With a Soviet growth rate of seven to nine per cent yearly, as against about three per cent for this country, it is not difficult, as Under Secretary Dillon has warned repeatedly, to guess at the outcome.

To get the whole answer, we are going to have to go to *research*. Adjustment of trade practices can do only so much and will not lend anything to growth, while reversal of our loan, aid and troop policies would be disastrous to national purposes, however beneficial they might be economically. We welcome the vigor of other countries' economies because it means a world with fewer tensions and discontents. If such health is a threat to ours, our only recourse is to find ways to *compete*, not destructively through economic warfare, but through products which can meet needs. This means lower-priced products and, what is more, the *kind* of products and services that can find their own acceptance. In the long run, only research can do the job.

Research has vast capabilities for bringing human talents to bear upon material secrets. But it confronts the user with an array of its own problems:

•What kind of research do we need and by what standards shall we measure what comes out?

•How shall it be paid for and how much can we afford to pay?

•Who is responsible for making all of these decisions?

Innovators' research

To begin at the most obvious point, an economy geared to world competition needs machines, materials and processes which are as inexpensive and efficient as possible. This is the task of *developmental* research, the innovators' research. Out of developmental research come the automated devices, the new synthetics, the physical techniques which drive down costs and boost productivity. We need innovation and we need to increase the *rate* of innovation, because the innovation factor takes on a greater importance once the transition from labor power to machine power has been made in industrial development.

Development, however, cannot go beyond the restraints of what is actually known. It must be fed by new uncoverings of everything from the atom to the cosmos; otherwise it will soon use up everything in the reservoir. To keep that from happening is the role of *basic* research.

The relationship of basic to developmental research has been debated fervently and at length, and still is not settled to anyone's satisfaction. In fact, there is little agreement on where one ends and

the other begins. To illustrate the difficulty, the universities estimated that for the academic year 1953-54 they received \$85 million for basic research from the federal government. The federal government reported for the same period, however, that it gave less than half that amount. Merle Tuve of the Carnegie Institution observes that much of the confusion is caused by the idea of "mission-directed basic research," in which "operations" intrude upon and distort the essential meaning of basic research. Tuve's definition of basic research—a nondirected "expression of wonder," an "almost passionate personal activity in search of new knowledge"—probably is as much to the point as any.

While wonder and passion are admirable qualities, they possess little appeal for hard-headed budget-makers, private and governmental alike, who cannot help but make policy-by-veto. Developmental research is salable to these gentlemen because it results in measurable savings which can be calculated as an investment/return ratio. Basic research cannot be so calculated; worse, it involves waste and failure because these are integral to the inquiry process.

Some of the tale is told in the figures. From 1945 through 1958, over-all research expenditures in this country increased from \$1,520,000,000 to \$10,230,000,000,

most of which was defense-connected. Government's share dropped from 70 per cent to 43 per cent over this period. The universities' share remained constant at about two per cent, but industry's investment went from 28 per cent to 55 per cent.

Industry was not only the heaviest investor, but also the heaviest user, consuming 65 per cent of the investment in 1945 and 79 per cent 13 years later. Government consumption of the total investment dropped from 28 to 14 per cent during the same period. The universities used up seven per cent of the total figure in 1950, 11 per cent in 1953 and seven per cent again in 1958.

Dim hopes

Where does basic research fit into this picture? In 1958, the American Association for the Advancement of Science estimated that by 1975 we would be spending \$20 billion a year for all research and development, but doubted that as much as \$300 million of that amount would go into basic research. The National Science Foundation drew attention in 1957 to the fact that the Soviet Union probably devotes about 14 per cent of its scientific manpower to basic research, which is between one-fifth and one-third more than we devote to the same ends. There is general agreement among all of the inter-

ested parties that hopes for improvement are fairly dim.

Thus, the problem of doing the research needed for future development is complicated by the imperatives of the present. This becomes even more true when we realize that developmental and basic research together can supply only a part of what we will need. We need more than devices; we need a wholly new kind of economic *operation*. Here the answers must come from what is now known as operations research.

Take the matter of cost-cutting devices. These immediately raise the issue of labor resistance—an economic as well as psychological factor, since diminished purchasing power will have grave repercussions within the economy. Take the problem of products. We produce automobiles efficiently, but the customer in the underdeveloped area may need public health equipment more. Or, he may think he needs a steel mill more than either automobiles or hygiene.

What to produce and for whom is, in its broadest terms, a policy decision. It cannot be made on the basis of economics or any other single consideration. It has to be made on the basis of national interest, and we cannot comprehend national interest until we know how each factor plays its part—until we can say for certain that given courses of action will cost this

much, and will have the following consequences. The process by which these factors are analyzed and the results prepared is operations research.

To illustrate this function, the experience of the government with air-power planning may be highly relevant. Where to allocate resources—money, materials, plant, personnel—was the problem during and following World War II. But the decision required knowing not only what this country could pay for, but also what results it wanted from its air power. Like the problem of the economy now, this question involved targets and people, political aims and sociological realities, as well as costs and profits. Neither airplane developers nor basic researchers could deal with the entire question properly. What was needed was the kind of research effort undertaken by the RAND Corporation.

Applied theory

A private organization with government contracts, RAND called in people from all the disciplines and put them together on teams, tying contributions together through applied theory. The Morgenstern-Neumann theory of games, to cite one example, proved very useful here. In essence, game theory makes possible the programming of alternate courses and the computation of the probable con-

sequences of each. The policy decision—where and how to allocate resources—can then be made with greater confidence because the relevant factors have been explored without reliance upon intuition and conjecture.

Admittedly not the entire answer, these objective techniques give the decision-maker something far more potent than the claims of contending factions. Something of the sort will obviously be required to separate and pattern the contending forces in reorganizing the economy for world competition.

'Monte Carlo' method

Some of what operations research can do for industry has already been established. Warehousing, shipping and supermarket management have already discovered and applied the usefulness of mathematical theory in planning and regulating the flow of stocks through depots, ships through ports and shoppers through checkout counters. Quality control and industrial engineering now solve their tasks within the plant with the aid of operations researchers, and even sales campaigns can be analyzed through the "Monte Carlo" method, in which the flow of promotional literature through an area can be measured against sales results in the same way that the probability of numbers "hitting" on a gaming table can be predicted

for the gambler taking his risk.

Where it paid off, operations research has been accepted. Can it be accepted where the payoff is in a far broader kind of national interest and where immediate returns for a single industry are not the prospect? The answer depends upon how successfully these points can be established:

- Inability to compete healthily in the world economic pattern is a symptom of this country's deteriorating internal situations. This situation calls for drastic measures, including a program of properly organized research in areas beyond defense.

- The end purpose of this research is neither austerity nor mobilization for war, but productivity and product-selectivity to serve both domestic and global needs.

- The efforts of sector interests, such as "labor" and "capital," to research and reorganize must be joint and cooperative. Otherwise the paramourcy of national inter-

est may lead to the impairment of certain of these interests.

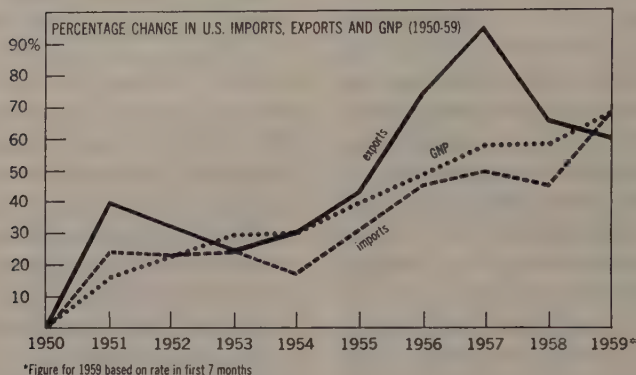
Getting these propositions across is a project in initiative and persuasion. We have had the experience of people of all orientations rising above immediate interest when the occasion is urgent and when the urgency has been properly presented to them. Government-industry-research collaboration, as exemplified by RAND, the Johns Hopkins Operations Research Office (in ground warfare research) and others, offers precedents identified as neither industry nor labor. These precedents constitute a formidable base of support for a national approach of this kind.

Research has the ability to confront problems, take them apart and clarify what can and what cannot be done. The critical issue is whether or not the institutions of this society and the attitudes which energize those institutions can be persuaded to give research its necessary sanction and support. ■

Medical Costs—Still Rising

IN 1959 Americans spent \$22 billion for medical services, double the amount spent in 1950 and six and one-half times the 1929 total, according to a recent survey by the Chase Manhattan Bank of New York City. Population growth accounts for part of the rise, but most of it is due to an increase in individual medical spending from \$27 a year in 1929 to \$124 in 1959. The cost of medical care has risen sharply—for example, charges for a one-day hospital stay have risen 73 per cent since 1950. Another factor in increasing medical expenses is the spread of medical insurance. Today, three out of four families have some form of health insurance.

THE IMPORT PICTURE



Increases in imports have been concentrated in a relatively few sectors, but these few spell domestic trouble

by Howard S. Piquet

■ MANY PEOPLE, lately, have received the impression that United States industry is no longer holding its own in world markets, while the domestic market is being flooded with imports. Their alarm is caused by careless reference to the current imbalance in United States international *payments* as a *trade* deficit.

While it is easy to confuse "balance of international payments" and "balance of trade," the two are quite different concepts. The former is a simple statement of the total number of dollars leaving the United States, set against the number of dollars entering the country, for any reason whatsoever, during a given period. International

payments and receipts are affected by imports and exports of goods and services, as well as American investments overseas, investment in the U.S. from abroad, foreign aid, support of overseas U.S. troops and tourist travel. Balance of trade, however, concerns only the value of our exports, set against the value of our imports.

Only in slight degree is our estimated \$4-billion deficit in balance of payments a foreign trade problem, since trade is only one part of the international payments that move dollars in and out of the country. It indicates neither that the United States is bankrupt nor that it is pricing itself out of world markets in any general sense.

But the uneasiness in the United States grows. The ubiquity of foreign consumer goods such as automobiles, cameras and radios, makes an immediate impact on millions of people, most of whom are unaware of the less dramatic changes taking place in the vast majority of the goods imported by the United States.

Imports of certain consumer goods, indeed, have increased to a degree that seems terrifying to their U.S. producers. For example, in the first seven months of 1959 the value of imported radio and television apparatus was over 3,500 per cent higher than in the comparable 1955 period. Similarly, in comparing the same two periods, imported automobiles increased 1,158 per cent, glass products 167 per cent, leather manufactures 147 per cent, meat products 126 per cent, cotton manufactures 114 per cent and photographic equipment 100 per cent.

Considered together, imports of these seven commodity groups in the first seven months of 1959 totaled more than \$1 billion and were four and one-quarter times higher than in the comparable 1954-55 period.

To conclude that these figures portray the whole import situation, however, would be analogous to describing the contours of an iceberg on the basis of the small part visible above the surface of the sea.

These seven commodity groups account for only 12 per cent of total imports in the 1959 period. True, imports of these seven commodity groups were four and one-quarter times larger in 1959 than in 1954-55. But imports of the other 88 per cent, totaling \$7.5 billion, increased only 25 per cent in the same period.

In comparing the import volumes of any two consecutive years, one should not be unduly impressed by large variations in the volume of imports between any two consecutive years. The Suez crisis, for example, caused a \$6.5-billion excess of exports over imports in 1957. This excess was more than double that of any year since 1950. In 1958, however, the excess of exports over imports receded to \$3.5 billion and in 1959 it declined further to \$1.3 billion.

At no time has the United States had an "unfavorable" balance of trade in the sense that merchandise imports have exceeded merchandise exports. Exports are still in excess of imports, although it is true that imports are increasing while exports continue to decline. As the graph on page 24 indicates, the growth of imports has paralleled the growth of the country's gross national product since 1950, while there have been two big bulges in exports—the first in 1951, following the outbreak of hostilities in Korea, and the second in 1956-57, following the Suez crisis.

Comparing imports in 1959 with imports in 1956, 1957 or 1958 gives a distorted picture, making it appear that imports have increased unduly in relation to the economy as a whole. One way of ascertaining whether or not import increases are an occasion for alarm is to compare them with the increase in the country's gross national product—the money value of all goods and services produced. Doing this, we find that imports increased 37 per cent in the period between 1954-55 and 1959. During the same period, the gross national product increased 29 per cent—eight percentage points less than imports.

If automobiles are omitted from the picture, the increase in imports is 29.7 per cent, a rate slightly higher than the rate of growth of the gross national product. Some imports, of course, have grown faster than the gross national product, but these gains have been largely offset by lines which have grown less rapidly or even declined.

A commodity analysis of approximately 85 per cent of the imports in the first seven months of 1959 shows that only \$1.5 billion worth of these increased at a faster rate than the GNP. On the other hand, the GNP increased at a faster rate than \$1.3 billion worth of imports. Thus, the relative "excess" of import growth over GNP growth comes to only \$200 million.

We can say, then, that although imports have increased substantially in the last five years, the increase has not been vastly out of line with the increase in gross national product. Indeed, if automobiles are eliminated from the picture, imports increased 30 per cent in this period—only one per cent more than the per cent of increase in gross national product. If iron and steel mill products also are excluded, the increase in imports is 27 per cent, or two per cent *less* than the per cent of increase in gross national product. With respect to all other products, imports which have increased faster than GNP have been offset by others which have either decreased or increased at a slower rate.

Changes in composition

The figures show, however, that there have been important changes in the composition of imports. Except for coffee and cocoa, imports of foodstuffs and beverages have increased at a faster rate than the gross national product. Meat products, in particular, have increased substantially. But the decline in the price of coffee has more than offset this general increase. As a matter of fact, foodstuff imports, as a whole, have increased at a much slower rate than the gross national product.

In examining the general picture of raw material imports we see,

again, that the over-all percentage of increase is not as great as the percentage of increase in GNP. The semiprocessed materials group shows a substantial increase, principally because of the increased imports of certain iron and steel mill products. Imports of ferro-alloys, however, have decreased.

Manufactures imports

Imports of manufactured goods have been increasing, both absolutely and in relation to gross national product increases. Automobiles account for the lion's share of this increase, although other consumer goods such as transistor radios and other electronic devices, photographic goods and synthetic fibers also show substantial percentage increases. Increases in imports of glass products, wool manufactures, cotton manufactures and a number of other products have been largely offset by the relative failure of imports of paper manufactures to keep pace with the increase in gross national product.

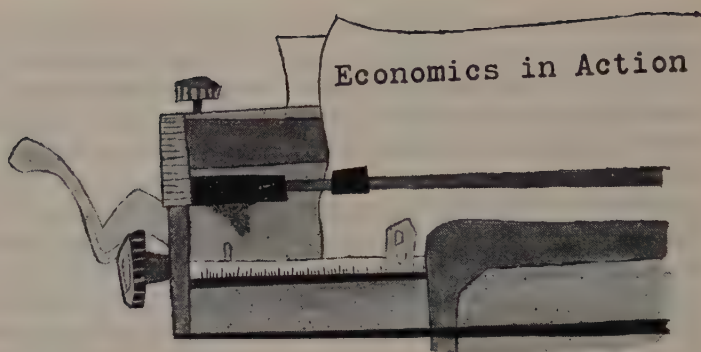
In view of these facts, it does not seem that the country is being inundated by imports in any general

sense. Nevertheless, it does not follow that big increases in imports of certain manufactured consumer goods have not, or may not, cause serious difficulties. The economy of the country is more complicated than an arithmetical total of its constituent parts might indicate. Changes in the pattern of imports can have implications of the greatest importance to the economy, particularly, as they produce pockets of unemployment in industry.

It would be incorrect, however, to attempt to solve the import problem solely from the point of view of producers who are confronted by import competition. Exclusive preoccupation either with the aggregate picture or with the problems of the producers of particular commodities will fail to present the national interest in true perspective. Whether or not individual producers should be given relief from rapidly developing import competition and, if so, to what extent, is primarily a problem of policy and politics. Without reference to economic facts, however, policy can be correct only through instinct or accident. ■

The World's Golden Nest Egg

GOLD brought back from early looting expeditions in the New World so increased European gold supplies that the economic structure of Europe was shaken. However, the total amount of gold produced from the time of Columbus' discovery to 1940 was only about 1,222,-000,000 ounces, or enough bullion to make a 44-foot cube.



mood of Congress

The honeymoon between the moderate Democratic leadership in Congress and the Republican Administration is now over. With the withdrawal of Governor Rockefeller making Vice President Nixon the almost certain Republican nominee, the overwhelmingly Democratic Congress is certain to launch an all-out attack on the Eisenhower Administration, whose policies Mr. Nixon is bound to support. Governor Rockefeller, on the other hand, was under no such obligation. An additional impetus for the Congressional leadership—which heretofore has tried to reach a compromise on most major issues with the President—to attack the Administration is the undeclared Presidential candidacy of Senate Majority Leader Lyndon Johnson with the strong backing of Speaker Rayburn. Even though they may not have enough votes to override Presidential vetoes, the leadership will try to delineate the Democratic position on major issues rather than attempt a compromise with the Administration. Such a compromise might result in more legislation but would blur the differences between the parties in an election year.

school construction

The initial test of strength will undoubtedly come on the Democratic-sponsored school construction bill which has already been approved by the Senate Labor and Public Welfare Committee. The measure, which is

certain to be vetoed if it passes in its present form, calls for \$1 billion in matching grants to the states over a two-year period for the construction of 50,000 classrooms.

Democratic proposals

Among other major Democratic-sponsored bills which affect the national economy and have strong political overtones in an election year are social security liberalization; the raising of the national minimum wage to \$1.25 an hour; an omnibus housing bill which will include provisions for public housing and urban renewal; and a bill already approved by the Senate to provide \$300 million in loans and grants to areas with a chronic unemployment problem. Regardless of the merits of each particular issue, the Administration cannot go along with very many of these bills as they are presently constituted and still fulfill its promise of a balanced budget in fiscal 1961.

key economic issues

Two key economic issues which will permeate this year's political rhetoric are the President's request to Congress for the removal of the four and one-half per cent rate ceiling on long-term government bonds and our balance of payments deficit which is intertwined with such perennial issues as foreign aid, reciprocal trade and "buy American." Influential Democrats are opposed to the lifting of the interest rate ceiling—which the Administration believes is necessary to refinance the government debt in the current tight-money market—because they feel that such a move would serve to make credit even scarcer and thus impose a hardship on the small borrower. The recent furor over the balance of payments deficit has given a renewed impetus to the demands of many industries for tariff protection against foreign competition and is likely to be reflected in the Congressional attitude toward a proposed liberalization of the reciprocal trade treaties. This issue will also undoubtedly be raised in an attempt to attach a "buy American" rider to the new foreign aid appropriation. ■



European competition

Recovery and integration have strengthened European economies to the point of displacing dollar goods in key markets

by Emile Benoit

■ THAT DOLLAR SHORTAGES are inevitable and more or less permanent is an idea which, until recently, had been defended, explained and elaborated on for a number of years by various economic theorists. Suddenly, however, the dollar shortage seems to have disappeared, and we have something more like a dollar glut. Other countries, particularly in Europe, are accumulating dollars more rapidly than they care to spend them. Even when restrictions on the purchase of U.S. goods are removed, their consumers often decide to buy what they need elsewhere. The dollar often exchanges at a discount, instead of at a premium against other currencies.

All this is most disconcerting, and not only to the theorists of the dollar gap. Possibly for the first time in our history, the U.S. balance of payments has become a matter of serious public concern.

The hastily improvised measures of the past few months do not touch the problem, because they do not take into account the trade shift that has become a part of the new international economy.

This new trade shift is a source of concern in that it reflects internal structural changes which seem to have rendered our economy internationally less competitive than in the past. Moreover, certain emerging developments, particularly European integration, are causing

additional difficulties. It is therefore urgent that we take stock of the situation and adopt whatever remedial measures are indicated.

Clearly, some factors behind the payments crisis are of little permanent significance. Some come-down in our export levels was inevitable after 1957, since the peak level of our exports that year was largely the result of the Suez crisis. The geographic distribution of our markets also had its effect on our export drop: Canada and Latin America were particularly hard hit by the world recession. In addition, the big build-up of our imports from Europe was partly caused by the vogue for small inexpensive cars, which simply were not being produced in the United States. Then, too, the U.S. began recovering from the recession before Europe, so that our imports were rising rapidly at a time when Europe's imports were still low.

Despite these qualifications, the fact is that since 1953 the U.S. has lost a share of its world markets to Europe. Our share in the world's exports of manufactures declined by two per cent between 1953 and the first half of 1958, whereas the share of Europe's Common Market countries rose by four per cent. By 1959 our situation had deteriorated even further. Does this reflect a decline in the international competitiveness of U.S. products? Evidence indicates that it may be so.

Between 1953 and 1958 our industrial exports (excluding military transfers) rose only 20 per cent, while France's exports rose 29 per cent, Italy's over 63 per cent and Germany's 113 per cent. It cannot be without significance that our industrial *export prices* rose much faster than those of our competitors. U.S. prices rose 13 per cent, while Germany's rose three per cent, Italy's only one per cent and those of France actually *declined*—if figured in dollars and adjusted for the depreciated exchange rate after the devaluation.

Rising labor costs have, it seems, played a significant part in these price movements. This does not mean that our wage rates went up faster than wage rates in Europe. The key factor is the rate of productivity increase, which has been rising much faster in Europe than in the U.S. Between 1953 and 1958 industrial output per man-hour rose 33 per cent in Germany, 35 per cent in Italy and 40 per cent in France, compared with an eight to 13 per cent increase in the U.S. (depending on the estimate used). Hence, wage increases in Europe could often be more easily met out of increased production per man-hour with less inflationary impact on costs.

As U.S. wage levels are around three times as high as in Europe, recent trends have added substantially more to over-all U.S. than

to European wage costs. After discounting for productivity gains between 1953 and 1958, real wage costs rose on the average somewhere between 13 and 20 cents an hour in the U.S., compared to four cents in Germany, and compared to a *decline* in wage costs in Italy and France. This may make U.S. industry more vulnerable to future competition. European productivity gains can still often be made in relatively inexpensive ways—by improved management or plant reorganization—while the U.S. must increasingly turn to the extremely expensive alternatives of installing highly automated equipment or introducing brand-new products or processes.

Higher growth rate

Why did European productivity increase so much faster than ours? The main reason seems to be the much higher rate of industrial growth generally, accompanied by a higher rate of investment. Between 1953 and 1958, German industrial output rose 52 per cent, that of France 47 per cent and that of Italy 41 per cent. In contrast, U.S. industrial output by 1956 and 1957 had risen only seven per cent above the 1953 level, and in 1958 it was back to the 1953 level. With U.S. plants in some years operating substantially below optimum capacity, productivity suffered directly and there was less

incentive for new investment and less pressure to improve efficiency.

Europe's improved competitiveness has other dimensions, which are possibly more important than prices and costs. The great expansion in production has made it possible for European industries to meet essential domestic needs and still have adequate supplies to push sales abroad. They can now promise quicker deliveries and have, in many cases, been able and willing to extend more flexible and liberal export credits than their U.S. competitors. Moreover, the technological and quality gap between U.S. and European products has been greatly narrowed. Over a wide range of products—textiles, typewriters, cameras, sewing machines, radios, automobiles and a variety of other products—it can no longer be taken for granted that the U.S. product is qualitatively superior.

The time lag between U.S. innovation and successful adoption abroad grows shorter and shorter, so that any slowdown in U.S. investment and research expenditure quickly reduces our lead. European business has also been more willing to produce what the consumer wants rather than to try to make him buy what the producer happens to have. We have preferred to stick to deluxe models, on which profit margins were higher, rather than to produce utility or special

export models which might have had a better sale. Where we have not priced ourselves out of the market we have sometimes upgraded ourselves out of the market. The case of automobiles is the most flagrant example.

The formation of the European Common Market (Germany, France, Italy and the Benelux countries) and more recently of the European Free Trade Area (Britain, Denmark, Sweden, Norway, Switzerland, Austria and Portugal), will in some ways make it harder to sell U.S. goods in Europe. Most U.S. exports will have to pay tariffs in these markets, whereas producers of each bloc will eventually be free to sell anywhere within the bloc without tariffs.

The amount of U.S. trade likely to be hurt is extremely difficult to estimate, but as long as the two blocs remain separate, no more than five to 10 per cent of our exports to Europe should be affected. If there is a merger of the two blocs, as the British and other members of FTA urgently desire, the extent of the damage will be greater, possibly affecting items covering one-fifth of our total trade.

Intent of integration

The tariff effect, however, may be less important than the rapid growth of the market and the enhanced strength of European producers. European integration is in-

tended to supply bigger markets, encourage adoption of mass production methods, break down barriers to competition, weed out inefficient units, permit capital and labor to flow more efficiently, and lead to more balanced and continuous economic expansion. Even if growth rates are no higher than they have been in the last five years, Europe's production and consumption should reach current U.S. levels during the 1960s. This implies an enormous increase in demand. U.S. exports likely to benefit are cotton, fats and oils, non-ferrous metals, and manufactures such as automation and nuclear equipment, which are highly research- and capital-intensive.

Rapid increases in European productivity and a further narrowing of the productivity and technological gap could well give additional competitive advantages to European producers. How much benefit U.S. exporters can derive from European growth will depend heavily on the extent to which U.S. growth policies encourage increases in productivity and competitiveness.

Where U.S. costs remain too high for exporting successfully, U.S. producers may find profitable alternatives in establishing production bases within Europe. Interest in this alternative is mounting. A recent survey by the McGraw-Hill Department of Economics showed

that American manufacturers planned to step up their rates of direct investment in Europe by 75 per cent between 1958 and 1960. This is hardly surprising when one considers the rate of return already being earned. In the recession year of 1958 earnings on U.S. investments in manufacturing in Europe averaged 17 per cent in the Common Market countries and 13 per cent in the Free Trade Area countries, compared with 10 per cent in Canada and six per cent in Latin America. (Figures are after foreign taxes—which can mostly be credited against U.S. tax liabilities.) These rates are enticing, and some European countries are now offering valuable special investment incentives besides. Such investments, admittedly, are alternatives to successful export programs. Yet they do bring certain benefits to our economy. Initially they swell the sale of capital goods to Europe, and later they increase the flow of foreign dividend remittances which help to keep down the U.S. payments deficit.

Export surplus imperative

It is absolutely imperative to keep U.S. industry competitive. For political as well as economic reasons we need to transfer some of our resources abroad to aid in world economic development. This can be done only by maintaining an export surplus. The crucial deter-

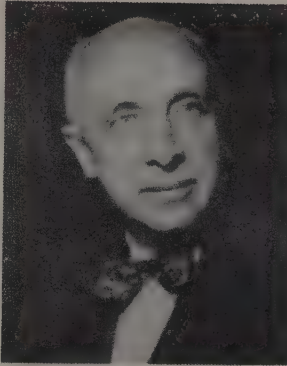
minant here is economic growth. If the economy stagnates so will productivity. And without rapid productivity advances our costs will almost inevitably rise. (Labor will not readily forego its ingrained expectation of periodic wage increases. Unilateral attempts by industry to break this pattern seem headed for serious trouble.)

To restore the rapid growth rates of which our economy is capable, we shall have to reconsider the restrictive monetary and fiscal policies which we have recently adopted to combat inflation. These policies have proved only partly effective in checking rising prices and, in addition, they have stifled our growth. It is urgent that improved and less dangerous methods be found.

It may be necessary to give growth a certain priority, and to make some temporary sacrifices in such other objectives as maximizing consumption, reducing income inequalities, increasing leisure, minimizing government's economic responsibilities and reducing debt.

Aside from the balance of payments question, growth is fundamental. We need to step up our growth rates to raise living standards (U.S. per capita disposable personal income *fell* in 1957 and 1958) and to demonstrate to the world that our type of economy and society can deliver the goods. ■

PERMANENT BATTLE AGAINST DISEASE



Does wealth breed health?

Are food additives harmful?

How much more longevity?

What makes new disease?

What makes us disease-prone?

JACQUES MAY

Director, Medical Geography Department,
American Geographical Society

TURN PAGE →

Permanent Battle Against Disease

Q *Dr. May, is it true, as most Americans believe, that we are getting healthier as we get wealthier?*

A That sort of question cannot be given a yes-and-no answer. If you are thinking of specific diseases, the answer is clearly yes. But if you speak of health in general, the answer is not nearly so clear cut.

Q *Well, how would you define health?*

A I don't know of any really adequate definition of health. It is much easier to define disease. To me, disease is any alteration of living cells or cellular tissue which jeopardizes the survival of those cells in a given environment. I think that this definition is important, because it brings disease back where it belongs—in the cells and tissues.

Q *You speak of the survival of cells in a given environment. Does this also include our geographical environment?*

A It certainly does. What is disease in New York may not be disease in China or Africa, or vice versa. Indians who live on the high plateaus of the Andes have eight and one-half million blood cells; human beings living at sea level have only between four and one-half and five million. This stresses the relationship between cells and environment in terms of adjustment and survival.

Q *How have social and economic changes in our own environment affected our capacity to cope with disease?*

A There can be no doubt that higher living standards and greater medical knowledge have helped us to deal successfully with past diseases. In the United States, for example, the communicable diseases of the 19th century, such as smallpox and cholera, have been almost

completely eradicated. Nutritional disorders resulting from a faulty diet have also been nearly stamped out. However, it would be foolish to think that we have licked disease forever. A change in our environment could easily create new disease problems and bring back old ones which we thought we had conquered.

Q *Could you give some examples?*

A As far as communicable diseases go, we are becoming increasingly aware of the importance of the neurotropic viruses—that is, the viruses which attack the central nervous system. Did they exist in the past? We do not know. If they did, we were not aware of them. I am afraid there is reason to believe that the future will see a considerable increase in anthropoid-borne encephalitis.

Q *Why have we been unable to eliminate all forms of communicable diseases?*

A It is an ecologic probability that, as we destroy known diseases, subdued forms of life that may be dangerous to us are rising to the surface.

Infectious diseases in modern hospitals

Q *Could you give us some examples of what you mean?*

A I think the statistics will bear me out when I say that mortality from infections in modern hospitals has not diminished since the Twenties and Thirties. For one thing, certain strains of staphylococci, for example, have become immune to our therapeutics. Also, it seems that certain strains which we discounted in the past as a cause of infection in the hospitals have become more important in recent years, bacillus pyocyaneus, for example.

Q *How about nutrition? As we lick old problems, are new ones arising?*

A I am afraid so. Our technology is creating new disease problems in this area. Here, I am not primarily concerned with the sort of contradiction existing between the advice of the food industry, which urges

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us to drink more milk and eat more meat, and the advice of the insurance companies, which beg us not to eat too much. I have something else in mind. To what extent does our technology render perfectly healthy food harmful? What is the relationship between the yellow we put in our butter or margarine and our liver cells? What about all the preservatives we put in canned foods? How is our nutrition being affected by the fact that today nobody eats fruit and vegetables grown in his garden? I don't say that all of this processing and preserving of food is necessarily harmful. Of course, our Food and Drug Administration is fighting to make it harmless. But the problem is so vast that nobody knows how much harm, if any, is done by our new food technology.

Technology and the creation of new health problems

Q *Dr. May, so far we have been discussing how changed environments are affecting old disease problems. Do you believe that our technology may also be creating entirely new health problems?*

A The most obvious example of a new health problem is, of course, the unknown results of increasing the amount of radioactivity in the atmosphere and in the soil. An old friend of mine, a French pediatrician and geneticist, has pointed out that certain mutations will probably be created at a faster pace by the increased mutagenic factors distributed over the earth. He is concerned not so much with those mutations which will be lethal as with those which, though they may not be apparent, will reduce an individual's immunity to disease. These factors may even increase our predisposition to disease.

Q *Why?*

A Well, for example, we do not know as yet why certain animals react differently to certain germs than man. Why can't you give leprosy to dogs, and why do very few men catch hoof and mouth disease? The best explanation is that the cells of individual organisms provide congenial environments for certain diseases and hostile environments for others. It is reasonable to fear that mutagenic factors might reduce or eliminate our immunity to agents which we never had to fight before.

Q *What other new health problems may our technology create?*

A Well, we are on the threshold of space travel, and we are already in the age of jet propulsion. What minute disturbances are created each time we submit ourselves to these abrupt changes in the physical conditions around us? We will have to cope with this problem sooner or later. Another problem is that of industrial wastes. Here, a major difficulty is the disposal of radioactive material. Some oceanographers are quite worried about the idea of using the ocean as a disposal ground for radioactive wastes. What is that going to do to the food that is in the ocean and the chain which links us and the rest of nature to this ocean food? I believe that any change brought about by radioactive wastes will have repercussions on the rest of nature. Similarly, atomic explosions concern me not only because of the effect these radiations may have on me and my descendants, but also because of their effect on the whole natural environment around the place where they occur. I simply can't conceive of such explosions not having an effect on the ecology of the area where they take place. And since all ecological niches in the world are probably linked together, I believe it is a foregone conclusion that a series of chain reactions from that area will reach the limits of the whole livable world. This, I believe, is a tremendously serious problem.

Social consequences of medical success

Q *Dr. May, some people are concerned about the social consequences of some of the more dramatic recent successes of medicine. Do you believe that our ability to wipe out crippling diseases is permitting the feeble to reproduce themselves, thus endangering the future survival of the race?*

A What you are really asking me to do is to discuss my whole philosophy of life. Of course, our ability to extend life expectancy is creating all sorts of social, economic and psychological problems. It is true that more of the "feeble" are surviving up to and beyond the reproductive age. Also, medicine makes it possible for the feeble to function more effectively. At the same time, it cushions the impact of their environ-

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ment, with the result that less is required of them. In other words, medicine allows people who would otherwise have been obliterated to survive and thus transmit their genes to other people.

Q *Is this desirable?*

A Well, we are supposedly living in a Judaeo-Christian civilization which cherishes an individual for reasons other than bodily achievements or social usefulness. Those we call feeble may, after all, be the most important ones in the eyes of a Superior Conscience. And there is another aspect to this problem. Only the other day I discussed the problem of retarded children with a colleague of mine. We both deplored the tendency of some people to begrudge the care and money spent for such children on the grounds that nothing can be done to make them "normal." We agreed that these children can play an extremely important role in bringing out the good in other people. Nurses, physicians and social workers who work with retarded children often become warm-hearted and loving persons. The children help them develop these tendencies. In fact, the "feeble" may strengthen us in more ways than the materialists of our age would imagine.

Slight progress in underdeveloped areas

Q *Let us turn, on this appropriate note, to the underdeveloped countries of the world where longevity is hardly a problem. Has 20th-century medical science really made much headway in these areas?*

A It all depends on what you mean by "headway." The number of deaths by cholera in India, for example, has generally diminished since the beginning of the century, although in 1958 there were still 30,000 such deaths and over 100,000 in 1953. And there are other instances which give us the bitter satisfaction of seeing what could be done if we had sufficient means and personnel. I have been engaged in public health works in the tropics all my life. In Vietnam, where we had a very good health system, we probably reached about 10 per cent of the population. The fact was that neither the Vietnamese economy nor the French taxpayer could afford to support a larger public health program. The

British, who have also done remarkable work in limited areas, have had the same experience. So far, I would say we have nothing but show-cases. We have not yet solved the big problem of adapting medical techniques to the billions of people in the so-called underdeveloped countries.

Q *In your opinion, what will have to be done before we can make a substantial dent in this problem?*

A What you are really asking is: How can the people of India, China and Africa be given the privilege of dying of cancer rather than of malaria? Well, they would have to have an industrialized environment, as we do in the U.S. and in Europe. Also, a tremendous effort to raise the general educational level would have to be made in order to train people to deal with their problems. Put that way, it seems clear that no such changes can take place in the near future. For example, raising the life expectancy of the Indian, which is currently 31 years, to our own 72 years, will take many decades.

Q *But why should it take that long? After all, these underdeveloped countries have at their disposal the latest medical techniques of the 20th century. Won't this enable them to lick these problems faster than the West did in the 19th century?*

A Well, it is theoretically feasible to arrest most of the known communicable diseases from which the billion and a half people of the underdeveloped countries suffer. We have already eradicated malaria in many places. A little more money would eradicate it everywhere. We can certainly protect any amount of people from cholera, given the time and the personnel to inject cholera vaccines regularly. The same thing could be done for any number of other scourges. But assuming that we had the money and personnel to deal with these diseases, what then? We would immediately create an overpopulation problem in areas where the food supply is already deficient.

Q *Isn't modern technology capable of producing more food for these people?*

A In the long run, perhaps; in the short run, I don't know. We have had several very disheartening experiments in applying West European

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techniques to the soil of tropical lands. It is still impossible to mention the English peanut project without making British officialdom shudder. And there are other examples. China is working very hard to transform itself into an industrial power. Even so, the cheapest power available to the Chinese authorities remains the muscle of its population. And for a long time this will remain true, simply because their labor force would remain unemployed if a sudden use of machines on a large scale would occur. In many countries, especially in tropical lands, the fertile layer of the soil is so shallow that the man with a hoe is still the best instrument for plowing it. I believe these difficulties justify my saying that it will take a long time before the bulk of the population of Africa, China and India can enjoy a standard of living approximating anything we know in the U.S.

Our changing natural environment

Q On the question of longevity, do you believe that our life expectancy will continue to increase as rapidly in the future as it has in the past?

A Your question reminds me of the man who came out of the casino of Monte Carlo after having won 100,000 francs in five minutes, and said to his wife: "I have to go back. Having won 100,000 francs in five minutes, there is no reason why I shouldn't be able to make a million in 50 minutes." I would say that it is extremely questionable that we shall be able to increase our life expectancy materially in the years to come. For one thing, we haven't begun to feel the full impact of new industrial techniques and greater organization. This may be harmful in a number of ways. There are a few warning signs, however. There is reason to believe that our food preservatives may not be as innocuous as we had thought, and there is definite reason to believe that something will happen as a result of increased radiation. Recent studies on the incidence of lung cancer reveal that smog and our smoking habits are creating a serious health problem. And these are just symptoms. We simply don't know what some of the other consequences will be.

Q Dr. May, you mentioned health problems resulting from food addi-

tives, smog, radiation, and so on. Would a controlled society find it easier to deal with these problems?

A A controlled society might be able to eliminate certain specific dangers, but it could not eliminate new dangers that will reveal themselves in the same fashion as smog and radiation have revealed themselves. It is absolutely unthinkable that we will be able to control everything in such a way that there will be no surprises. I just don't believe that paradise is possible in this world. We shall go on adjusting to environmental circumstances and, I hope, to changing environments.

Q *Are you saying that our control over living nature is never absolute?*

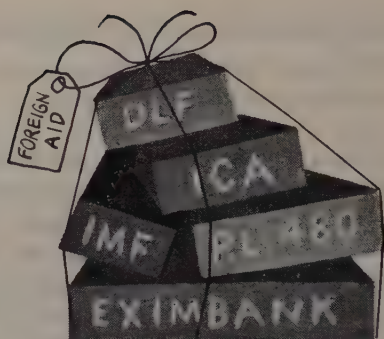
A That is right. As I have explained in my book, *The Ecology of Human Disease*, any living thing lives in society. That is true for men, animals and bacteria. In the past 20 years we have successfully controlled some of the bacteria and parasites which challenged our survival. But in doing so we have disrupted the ecological balance, and we are beginning to see previously subdued forms of life rise to power. This is quite a common development in nature. When you kill all the mongooses in the jungle, you will see hordes of serpents. When you put a cat in an attic, you see a decreasing rat population. At present we do not know what the new agents will do to us. All we can do for the time being is study them and suffer their insults.

Q *Shall we ever be able to control our natural environment completely?*

A I don't think so. New situations are unforeseeable. In part, they are a product of our expanding knowledge. There were no bullet wounds in antiquity, no airplane crashes in the 19th century and no radioactive burns before the beginning of the 20th century. We cannot forecast what the problems of the future will be. All we know for certain is that the chain of succession in adjustment and maladjustment will continue. At times, this will result in a temporary rise in life expectancy; at other times it will mean a reduction in life expectancy. This, I believe, is the only safe prophecy we can make.

Q *Thank you very much, Dr. May.* ■

U.S. foreign aid programs
have had little effect
on our current balance
of payments problems



Does Foreign Aid Hurt the **DOLLAR?**

by Robert J. Alexander

■ THE UNACCUSTOMED SPECTACLE of an adverse balance of payments for the United States has provoked wide discussion of the role played by this country's foreign aid program in bringing about this situation. The Eisenhower Administration has thus far indicated its concern by requesting Development Loan Fund grants to be spent in the U.S., and there are rumors of other measures to be taken.

I think the fears aroused by the temporary appearance of an adverse balance of payments are greatly exaggerated, since the fundamental causes which made the United States a creditor country a generation or so ago continue to operate.

During World War I the United States was converted from a debtor nation into a creditor one. Many

foreign investments in this country were liquidated at that time, and both private citizens and the U.S. government made extensive loans to the European nations. However, it took some time for this country to adjust to its new position.

The reason for the change in the international economic role of the United States was perhaps not fully understood by public officials and even by many economists. Basically, it was the fact that the U.S. had become the world's largest industrial nation. The quality of our goods was high and our prices were competitive.

With the rest of the world anxious to purchase a wide variety of goods from this country, the problem was to find a way of financing these purchases. Before

World War I some purchases were financed by income from previous foreign investments in this country and by services—banking, insurance, shipping, etc.—which other nations performed for us.

However, by 1918 the situation had become more complicated. This country was now earning net income from its investments abroad, rather than paying out dollars which could come back to us as a demand for our goods. We had superseded Britain as the world's main banker.

Moreover, throughout the 1920s and early 1930s, the United States retained high protective tariffs, making it difficult for other nations to pay us in goods for our goods and services which they needed. If our potential customers were to be able to buy goods from us, they had to be supplied with the requisite dollars.

During the 1920s the "dollar gap" was met by very extensive private lending by U.S. citizens who bought German bonds and the securities of myriad Latin American countries and who, to a lesser degree, built factories and other enterprises overseas.

With the advent of the Great Depression, the source of private loans dried up. At the same time, the United States raised the highest protectionist barrier in its history, the Smoot-Hawley Tariff, thus making it exceedingly difficult

for foreign customers of the United States to sell us goods. The dollar gap was bridged principally by our customers' payment in gold of the difference between goods which they bought from us and goods we purchased from them. By the end of the 1930s most of the world's gold supply—except what was held by the Soviet Union—was in the United States Treasury's vaults in Fort Knox.

During the 1930s, too, the first hint of a foreign aid program appeared, with the establishment in 1934 of the Export-Import Bank, for expediting the foreign trade of this country by loans to U.S. exporters and foreign importers of U.S. goods. With the advent of World War II, foreign aid became the principal bridge over the dollar gap. Successively, with the Lend-Lease Program, the \$5-billion post-war loan to Britain, the Marshall Plan, and the Mutual Security and Point Four Programs, our potential customers were supplied with the dollars needed to acquire our goods and services.

Meanwhile, important changes in the world situation added new political significance to our program of economic aid. First, the United States emerged from World War II as one of the globe's two great powers, and immediately became involved in the cold war with the other great power, the Soviet Union.

Secondly, the postwar period saw the political and economic emergence of the countries of Asia, Africa and Latin America. Economic development has become the cornerstone of official policy in all these nations.

In spite of the xenophobia which is part of emerging nationalism in many underdeveloped nations, most of these countries are willing and anxious to receive outside help for their economic development. They realize that economic growth will be less painful if needed capital can be obtained now and paid for from the increase in national income resulting from the use of this capital equipment.

Powerful argument

The United States has been the most important source of help to underdeveloped nations. U.S. dollars have been made available in a variety of ways. They have come from the Export-Import Bank (particularly in Latin America), from the International Bank for Reconstruction and Development, from the Mutual Security Program as grants and loans, and from the Surplus Commodity Program as wheat.

Obviously, the United States has not carried on its extensive foreign aid program for purely altruistic reasons, though the dire need of the underdeveloped nations is in itself a powerful argument for

such a program. Increased travel facilities, the speed of modern communications and rising nationalism in the underdeveloped countries, have made inevitable a growing resentment—whether reasonable or not—at the obvious disparities of wealth between us and the underdeveloped two-thirds of the world. In recent years, Soviet ventures in economic aid—though not yet as great as our own—have brought the problem into the realm of U.S.-Soviet rivalry and thus intensified its urgency.

The impact of U.S. foreign aid on the total United States economy should not be overestimated. In recent years, mutual assistance appropriations have not been running more than \$3 billion to \$4 billion a year, while our total exports at the end of 1959 averaged approximately \$15 billion a year—about 20 per cent of total U.S. exports.

The quick recovery of Western Europe has created a new situation affecting the balance of payments position of the United States. Where United States aid has not been made in the form of loans or grants expendable only in this country, some recipients have preferred to spend some of their dollars outside the United States. Where they have been able to get goods of equal or better quality for less money, they have preferred to buy in Europe.

The situation has been aggra-

vated by West European barriers to the import of United States goods. Most of these barriers were erected during the difficult times of the late 1940s, when West Europeans wanted to purchase more here than they could afford.

No longer scarce

Today, dollars are no longer so scarce in Western Europe and, since the restrictions on U.S. goods have remained in effect, the increased dollars received by these nations have tended to go into their own foreign exchange reserves rather than returning to the United States as a demand for our goods and services.

Even so, the extent to which our loans and grants to the underdeveloped countries have been "untied," and thus available for expenditure in other nations, should not be exaggerated. All Export-Import Bank loans are "tied"; the International Bank loans made in dollars must be spent here, and most Mutual Security funds could only be spent in the United States. Of course, surplus commodity aid involved only products grown in this country. Only a fraction of the Mutual Security funds and some of the loans of the new Development Loan Fund have been available for spending outside the U.S.A.

Thus, the foreign aid program by itself has certainly not been responsible for creating an adverse

balance of payments for the United States. The rapid recovery of Europe and its return to active competition with the United States, as well as its failure to modify the trade barriers of the 1940s, have undoubtedly been of greater importance than the foreign aid program.

Certain moves have been made recently to remedy the situation created by European discriminatory barriers against U.S. goods. France, the Netherlands and other countries have reduced their barriers against entry of United States goods, while more reductions in these trade barriers are promised for the immediate future.

These measures are likely in the near future to ease pressure on the United States' balance of payments. In any case, the dangers arising from the present adverse balance of payments of this country should not be exaggerated.

Certainly the situation which existed after World War II was an "unnatural" one. It is certainly good that Western Europe no longer needs our aid and that it is in a position to extend considerable aid to underdeveloped nations.

We must, however, admit that a continuing balance of payments deficit of the size which the United States had during the early months of 1959 would not be healthy. Such a drain could not continue for more than two or

three years without giving rise to serious problems. In order to avoid such eventualities, there are several measures which would seem to be in order.

First, the United States should certainly seek to encourage greater participation by Western Europe in aid to underdeveloped nations. Goods which the countries of Asia, Africa and Latin America wish to purchase in Western Europe should be financed by loans and grants from the countries involved, rather than indirectly through loans and grants from this country.

Secondly, it might be possible to reduce United States expenditures abroad, especially on certain military items.

Third, the United States can, in the long run, prevent an unfavorable balance of trade only if it can make its products internationally competitive. We have done this in the past because, in spite of our high wage rates and standards of living, we have substituted the machine for human labor, and have found it possible to turn out more

goods at a lower price as a result.

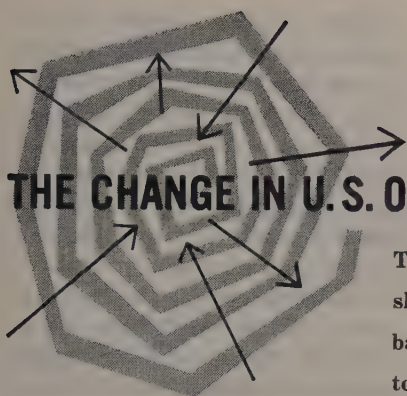
It is in the continuation of this historical trend that the effective solution for an unfavorable balance of payments is to be found. At the moment, the principal development in this field is automation. If the United States wishes to remain competitive without reducing its own standards of living, it must hasten the progress of automation.

Little has as yet been done to come to grips with this problem. It might be well for the federal government to take the leadership in the development of a program for stimulating automation and dealing with the inevitable dislocations resulting from a substitution of machine for labor power.

To sum up, it is fair to say that there is no reason for panic as the result of our temporary balance of payments deficit. It is not correct to attribute this deficit to the foreign aid program. Most foreign aid credits and grants have been spent in this country and so have not contributed significantly to our balance of payments difficulties. ■

Seaway Progress Report

SHIPPING on the St. Lawrence Seaway carried 20,103,767 tons of cargo during the international waterway's first season of operation. This volume was 71 per cent greater than that of last year's operation on the old St. Lawrence Canal. Total revenue was approximately \$714,000 short of early estimates. Experts predict that, by 1968, Seaway shipping will carry 50 million tons of cargo per year. They see a significant trend toward larger ships on the Seaway in coming years. Several vessels 730 feet long and 75 feet deep will be in service this year.



THE CHANGE IN U.S. OVERSEAS INVESTMENTS

There has been a significant
shift in emphasis from
basic commodities
to manufacturing industries

by Robert P. Ulin

■ SINCE THE END of World War II, foreign investments of U.S. business have become a major factor in total U.S. private investment. The value of U.S. direct investment-foreign operations in which U.S. firms hold a controlling interest-rose from \$11.8 billion in 1950 to \$27.1 billion in 1958. In addition, U.S. citizens held \$9.7 billion in foreign bonds and securities. This substantial increase in overseas investment promises to grow even larger.

The principal motive for U.S. foreign investment in the postwar period has been the need for raw materials-petroleum, iron ore, bauxite, etc.-to support our rapidly growing domestic industries. Recently, however, there has been a gradual shift toward investment in manufacturing facilities. This has

brought about an accompanying shift in the geographical pattern of U.S. foreign holdings. In the past these holdings have been concentrated in the Western Hemisphere, but now they are being diverted to Western Europe.

There are indications that this shift will become more marked in the future. A recent survey of foreign operations of United States business made by McGraw-Hill indicated that in 1959 and 1960 U.S. investment in Europe would grow substantially more than investments in either Latin America or Canada. The survey also indicated that foreign manufacturing operations would continue to grow, although petroleum operations would remain the largest outlet for U.S. investment abroad.

Behind this changing pattern of U.S. foreign investment is a series of developments that have improved the political and economic climate of Western Europe in recent years.

In the political realm, the danger of internal Communist coups in Italy and France has abated, and the socialist parties, which dominated many early postwar governments, have been gradually losing ground to parties committed to the free enterprise system. This was dramatically demonstrated in last fall's third straight defeat of the British Labour Party.

The efforts of these conservative European governments to promote investment and the success of the Marshall Plan have been the major factors in the economic growth and stability of Western Europe. This growth and stability, in turn, has created an attractive climate for U.S. investors.

Profits picture

The most important economic factor in the growth of U.S. investment in Europe is the very basic one of profits—profits that are higher than in comparable operations in the United States. These investment opportunities exist because the European market for many products is growing faster than the U.S. market.

Industrial production in Europe has almost doubled since 1948.

Western Europe's gross national product climbed from \$148 billion in 1948 to more than \$240 billion in 1958, in constant dollars. Per capita income increased 50 per cent during this period, and total consumer spending rose from \$105 billion in 1948 to almost \$160 billion ten years later.

U.S. firms entering the European market to take advantage of this increased consumer purchasing power are tapping relatively virgin territory, compared with the well-stocked households of the U.S.A. In West Germany, for example, there were in 1956 only 52 passenger cars per 1,000 people—less than one-sixth the ratio for the U.S. Similarly, the market for television sets, refrigerators and other major products presents promising opportunities.

European governments are encouraging investment by offering liberal tax policies and depreciation allowances along with interest-free loans for industrial research. Another major incentive to foreign investors was the return of most European currencies to full convertibility in 1958, thus permitting U.S. concerns to repatriate the earnings of their European operations without restriction. All of these developments have made Western Europe a more attractive operating locale for U.S. business.

The establishment of U.S. manufacturing operations in Europe is

also due in part to trade and tariff restrictions adopted during the postwar period. These restrictions present serious obstacles to the export of many U.S. products to Europe. And the new trade groupings will discriminate even more strongly against some manufactured goods from nonmember countries. In order to take advantage of growing European markets, then, many U.S. firms have had to establish plants in Europe rather than attempt to step up their exports against these trade barriers.

Huge market

Both the Common Market and the recently established European Free Trade Association will doubtlessly influence the pattern of U.S. investment in Europe. Until now almost half of U.S. postwar investment in Europe has gone to Great Britain because of the advantages of preferential tariffs in dealing with Commonwealth countries. In the future, however, U.S. firms in Britain will find it increasingly difficult to sell to the European nations comprising the Common Market. Setting up manufacturing operations within Common Market countries may be the only way U.S. firms can reach the market evolving in this area.

There is already evidence that the establishment of the Common Market has influenced the flow of U.S. investment funds abroad. This

is one of the reasons for the formation of the European Free Trade Association under British leadership. These nations hope to attract a similar flow of U.S. investment funds to the "outer seven."

In sharp contrast to the business climate in Europe is the business climate of many underdeveloped areas of the world. Latin America, in particular, has lost much of its appeal for foreign investors. Although dictatorships have fallen throughout Latin America in recent years, the governments that have replaced them stand on very shaky economic foundations. Hypernationalism threatens the security of foreign properties in many of these countries. In addition, the market for consumer goods is limited by low income levels and by inflated costs of production and distribution.

Plague of inflation

Many Latin American nations have been plagued by a rampaging inflation which has seen the cost of living in Argentina more than double since 1953 and that in Bolivia increase by an astonishing 2,500 per cent. Thus, American firms operating in these areas are confronted with constant political turmoil and continuous pressure for large wage increases. Furthermore, softness in petroleum and other commodity prices has acted to discourage investment even in

primary industries in recent years.

But the picture is not entirely black. In Argentina industrial production increased 25 per cent between 1953 and 1958. Other underdeveloped countries, particularly Brazil and India, have also registered impressive gains. Recent measures by some of these governments to insure foreign capital against expropriation may encourage new investment by American business. And in the U.S., Congressional action to stimulate investment abroad may be forthcoming.

It is desirable for both humanitarian and political reasons that the economic growth of the underdeveloped nations be accelerated. But the economic well being of these countries depends to a large extent on the actions of their own governments as well as on the actions of industrialized nations. These governments must recognize the need for foreign investment and must be prepared to encourage a political and economic climate that will foster such a flow. In this context, the current wave of nationalist agitation in Latin America is most unfortunate.

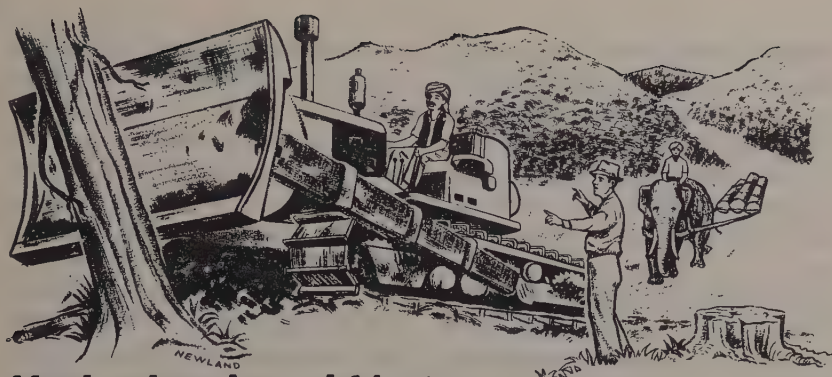
U.S. investment abroad has had beneficial political and economic effects, and is certain to continue to do so in the future. Currently, it contributes to our balance of payments deficit and is, therefore, a problem as well. In the long run, however, the deficit will be partially balanced by the repatriation of earnings on U.S. investments abroad.

The U.S. balance of payments deficit can be further alleviated if European trade blocs assume their obligation to relax trade restrictions imposed during the post-war dollar shortage. If this obligation is not assumed, U.S. goods will not be able to enter European markets on a truly competitive basis. This could lead to increasing protectionist sentiment in the U.S., and even to curtailment of the free flow of U.S. capital.

The Western coalition must develop a cohesive economic strategy in conjunction with those already existing in the military and political spheres. The free international movement of private capital, European as well as American, is our best hope for the economic viability of the non-Communist world. ■

Computers Play Baseball

SCIENTISTS confined to a laboratory during the baseball season are tempted to enjoy the sport with computers: an IBM 709 computer plays individual innings and plans strategy for given conditions.



Underdeveloped Nations Need Investments, Too

by C. V. Narasimhan

An Indian economist outlines the prerequisites for increased private investment from abroad

As a component of the growing "one world economy," the rapid expansion of U.S. private investment overseas has created new problems while solving old ones. This investment can be of considerable significance to a developing country, but it also aggravates our own balance of payments problem. Yet so great is the importance of this investment to the economic health of the entire free world that we must encourage, rather than discourage, it.

The author, who is Under Secretary for Special Political Affairs in the United Nations, explores the causes and effects of private foreign investment from the points of view of both the investor and the country seeking such investment. While drawing on his experience, both as a senior official of the government of India and as Executive Secretary of the UN Economic Commission for Asia and the Far East (ECAFE)

for two and one-half years, Mr. Narasimhan points out that the views expressed in the article are his own and should not be attributed to either the United Nations or its Secretariat.

■ THE WORLD TODAY is convinced that the international community has a clear responsibility to promote the economic advancement of the developing countries. In their efforts to raise their living standards, these countries must, of course, make the major effort themselves. But they also need assistance from external sources, whether on a bilateral, government-to-government basis, through international agencies or by the investment of foreign private funds.

While opinions may differ on the

relative importance of private foreign investment, statements from the various governments of industrially developed nations indicate the importance they attach to such investment as a means of assisting the relatively underdeveloped countries.

The Colombo Plan Consultative Committee noted recently that while many developing countries in the region are taking positive steps to encourage the flow of private foreign investment into their countries, this investment remains comparatively small even with its recent growth. The Reserve Bank of India similarly reports that the inflow of private capital to that country continues at a low level, particularly when compared with the assistance received (from foreign governments and loans) from the International Bank for Reconstruction and Development.

Reinvested profits

A study by the United Nations Secretariat, meanwhile, states that between 1955 and 1958, the aggregate outflow from the main capital exporting countries (including retained profits of foreign branches and subsidiaries) exceeded \$17 billion, with about half this total going to low-income, underdeveloped countries. While private investment in developing countries equalled foreign government assistance, it did so only by virtue of the prof-

its reinvested by foreign businesses already established within these countries. In other words, government aid to developing countries considerably exceeded the amount of *new* private investment made.

What are the reasons for the comparative reluctance of foreign investors to put their money in developing countries? The United Nations study concludes that the investment and market opportunities which advanced industrial countries offer each other tend to absorb a large part of the investment funds available—e.g., U.S. private investment in Canada.

Next in preference for foreign private investment come the low-income countries with natural resources, mostly oil and nonferrous metals. Nearly all foreign investment in these countries is made by large international companies interested in developing the nation's natural resources—i.e., oil in the Middle East and Latin America, and minerals in Africa.

Last place goes to the low-income countries having neither important natural resources nor domestic markets for absorbing the production of large enterprises. These countries continue to receive little private capital. In Africa, Asia and in Latin America, private foreign investors contribute relatively little to capital formation in the countries of lowest incomes and natural resources.

While government grants and loans correct this imbalance to some extent, it must be remembered that government aid itself is uneven. For example, although low-income countries received considerable international economic aid from 1954 to 1957, countries with annual per capita incomes of less than \$100 received less aid than countries with higher per capita incomes. The magnitude of this problem is emphasized by the fact that the poorest countries are also those where domestic capital formation can hardly keep pace with population growth.

On the other hand, portfolio investment, and the availability of medium- and short-term capital, mainly in the form of export credits, has increased markedly in recent years. Although such capital cannot be considered a stable element in the financing of economic development, it has contributed significantly to international liquidity and has helped many developing countries tide over their balance of payment difficulties. Perhaps the major development of the last few years in this field, however, is the emergence of Europe as a steady capital supplier.

Persistent shadows

Brighter though the general picture may seem, it has persistent shadows. While international investments have entered a new

phase, and while the prospects for a greater flow of private capital and for a greater contribution of this capital to economic development appear greater than ever before, the situation is still unbalanced. Many countries remain unable to attract significant amounts of any form of private investment.

I have reviewed at some length the main conclusions of the United Nations study because they illustrate some of the often-neglected considerations affecting the flow of private foreign investment to underdeveloped areas.

In general terms, there are at least three basic factors involved—profitability, familiarity and security. Security involves guarantees against expropriation, inconvertibility of earnings and depreciation of investment through currency fluctuations. While less specific in its definition, profitability requires opportunities for investment in fields where a reasonable return on the investment may be expected. Familiarity can be either geographical or technical. That is, it can be familiarity with either the country or the type of business in which the investment is to be made.

It seems fairly obvious from the United Nations study that the presence of all three factors can produce a considerable flow of private foreign investment, while the absence of any one of them can greatly reduce this flow.

Almost everyone who talks about creating a favorable investment climate seems to think only in terms of security and to ignore the other two factors. Many feel that an international investment charter or convention would guarantee the existence of all three. But it seems to me that even if such a contention or charter were formulated, and all underdeveloped countries persuaded to accede to it, it could deal only with investment security. This, experience has shown, would not be sufficient.

Excellent record

For example, even though India has an excellent record of meeting her international financial obligations, the Reserve Bank of India reports that in 1957 the gross inflow of private foreign capital into India amounted to only 259 million rupees, including 96 million rupees of reinvested profits. It is obvious that this total made a relatively small contribution to a budgeted expenditure of *8.6 billion* rupees on the Indian Five-Year Plan during 1957-58. (The rupee is valued at approximately 4.75 to the U.S. dollar.)

Thus, it would seem that the other two factors—profitability and familiarity—are of greater importance than security in determining the flow of private foreign investment into a country like India. Profitability—both the opportunities

for profit and the ability to do with it what the investor decides—are of great significance. In India, for example, particularly in industry, a substantial public sector of the economy cannot ordinarily be assisted by private foreign investment. (Exceptions may be possible, as in oil refining.) It thus appears that limiting the variety of profitable opportunities for foreign investment can reduce the flow of such investment.

While on the subject of profitability, we should consider the role of both capital-exporting and capital-importing countries in concluding suitable tax agreements to achieve a degree of reciprocity, so that advantage is not taken by one government of the concessions granted by the other. India and the United States have recently signed a treaty which grants important concessions to United States-financed firms in India, and provides that income earned as a result of these concessions shall be treated by the United States as tax-free income.

We come now to the factor of familiarity and the role which it can play in attracting foreign private capital. As a result of recent surveys disclosing the existence of about 400,000 square miles of potential oil-bearing areas in India, the Indian government has invited foreign companies to join in the search for oil. Thus a field which

has attracted considerable foreign investment to other countries will be opened to similar investment in India. It will be interesting to see, five years from now, what effects this change of policy has had on the over-all picture of private foreign investment in India.

Considerable risks

This change in policy also illustrates the importance attached to familiarity. The heavy foreign investments in petroleum extraction in Latin America and the Middle East seem to demonstrate that where a field of investment is familiar, foreign capital may be expected to flow even where the risks are considerable.

Another example of the importance of familiarity was the heavy British investment in Indian plantations during the days of a colonial relationship between Britain and India. Similar investments have been made in other parts of the former British Empire in the ECAFE region, e.g., rubber in Malaya, tea and rubber in Ceylon. The same situation no doubt holds true in the overseas territories of other metropolitan powers. This is a natural kind of flow illustrating the value of all three factors—security, profitability and familiarity. In many cases the investment remains even after the colonial relationship has ceased. While there may be some withdrawal of investment, it

usually takes place gradually and is replaced by fresh forms of investment. An example of this is the shift in foreign investment in India from the traditional outlets of plantations, trading and transport to manufacturing and, in recent years, petroleum refining.

The problem of “creating” familiarity can be met, in part, by the promotion of joint international business ventures. The private foreign investor brings a certain amount of capital (in the form of machinery and advanced technology), while the local partner contributes those facilities which can be purchased with local currency such as land and buildings. The local partner is also able to take care of the various formalities required by his own government. One great advantage of such an arrangement is the technical assistance contribution of the foreign investor. Of particular importance is the fact that this is a continuing contribution, because the enterprise in the underdeveloped country will continue to benefit by the research done in the advanced country.

A second aspect of the problem of creating familiarity involves red tape in the capital-importing countries. Here underdeveloped countries have a clear responsibility, so that the would-be foreign investor does not feel that he is caught up in a strange jungle with all kinds of unseen hazards and

hostile forces surrounding him.

In the case of India, for example, many of the regulations governing private foreign investment affect the private sector of the economy in general. While the local private businessman may be able to cope easily with the various regulations, the foreigner may find them to be a serious deterrent. Many of these regulations can be time consuming, and a foreign entrepreneur simply does not have the necessary time to spend in the country in which he wishes to invest.

I hope that in their future thinking on the measures to be taken to attract private foreign investment, underdeveloped countries will not think exclusively in terms of offering investment security and guaranteeing repatriation of earnings and, ultimately, capital. It is equally important that these countries pursue policies designed to enlarge the opportunities for prof-

itable foreign investment, and to encourage this investment by appropriate tax concessions.

Another useful step would be to set up centers where the prospective foreign investor can readily obtain information about the availability of opportunities for private investment, markets existing for various products and the minimum government regulations with which he will have to comply. It would also help if such centers could, where requested, put the foreign investor in touch with a local entrepreneur who might be interested in joining with him in a business venture.

If all these steps are taken simultaneously, there is reason to hope that considerable stimulus would be given to the flow of private foreign investment to those countries which desire such assistance in their efforts to promote their own economic development. ■

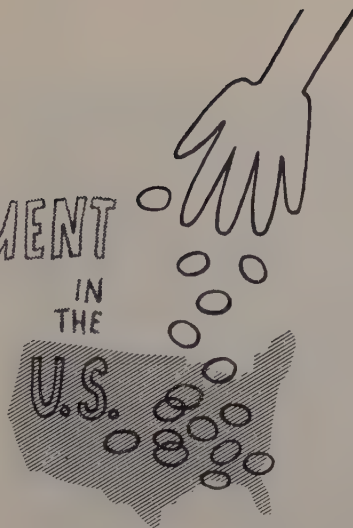
Spreading Capitalism

THE International Bank for Reconstruction and Development—popularly called the World Bank—has assured underdeveloped nations of an uninterrupted supply of capital for their expanding needs during the 1960s. A recent decision doubles the Bank's authorized capital from \$10 billion to \$21 billion. Loans made by the Bank over the past few years have been at a record rate, averaging \$700 million a year. They may reach \$1 billion a year within a few years. Since its inception in 1944, the Bank has made loans totaling over \$4.6 billion. So far, the loan breakdown by area is: Africa, \$589 million; Asia, \$1,404,000,000; Australia, \$317 million; Europe, \$1,370,000,000; and Latin America, \$981 million.

FOREIGN INVESTMENT

It runs surprisingly
close to the
level of U.S.
investment overseas

by Roy Blough



■ THE PICTURE of overseas operations by United States businesses has been growing larger and more intricate in recent years, a development which has had some bearing on the unfavorable international payments position of the United States. The payments crisis, in turn, is now calling attention to the other side of the picture—that of foreign holdings in the U.S.

Foreign claims against U.S. gold and dollars are, in part, the outgrowth of U.S. imports of foreign goods, but they are also the result of foreign business investment and operations in this country. It is a paradox that European businesses should seriously consider investing in the highly competitive United States market, or that foreign capital should be sought by this country. It was indeed something of a shock to read in November, 1959,

that the governor of North Carolina went to Europe with a delegation of 68 manufacturers, bankers, shippers and state officials in order to attract European investment to his state. The delegation, after interviewing about 1,000 businessmen and officials, reported some success and anticipated more. It was a “man-bites-dog” story, in view of the large pool of United States capital, the large outflow of that capital to other countries, and the new investment incentives provided by the European Common Market.

A look at the facts of foreign investment and business in the United States shows that man has been biting dog for some time now with a fair amount of ferocity. At the end of 1958 the value of foreign assets and investments in the United States was estimated at

\$34.8 billion—only \$6 billion less than the value of United States private investments in foreign countries.

If we break this figure down, however, we find that only \$4.9 billion was in the form of direct investment, or actual foreign ownership of business property in the United States. The balance included \$19.6 billion of short-term holdings. \$8.3 billion of United States corporate stocks (other than direct investment), and \$3.5 billion in bonds and long-term U.S. government securities.

Prestige and security

In examining these figures one is struck by the size of the short-term holdings. This large sum placed in short-term assets indicates the value placed by foreign governments and businessmen on the dollar. They use it as a method of settling international balances and as a desirable form in which to keep monetary reserves. The continuation of these large holdings depends largely on the confidence their owners have in the future stability of the international purchasing power of the dollar. The rate of interest which can be earned on short-term investments in the United States is another important factor. The holding of gold gives us prestige and a form of security, but it is an unprofitable operation in that gold earns no interest, while

short-term dollar assets pay substantial rates of return.

Longer-term government and corporate obligations are obviously deemed to be a good investment. United States securities are also highly valued. It should be noted, however, that most of the large gain in the value of U.S. securities held abroad has resulted from the appreciation in their market value rather than from new investments in them.

Direct investment by foreign business in the United States grew from \$2.5 billion in 1946 to \$4.9 billion by the end of 1958. Only \$0.9 billion of the \$2.4 billion gain represented the inflow of funds from abroad; the remaining five-eighths were reinvested earnings.

Foreign funds in direct investment were coming into the U.S. at the rate of \$100 million a year in 1946. In 1955 \$300 million—the maximum amount to date—came into the U.S. in direct investment. In 1958, however, the investment was the smallest in 10 years—\$158 million. This appears to be only a temporary lull as the Department of Commerce, the official source of these figures, reports the prospect of a number of new projects.

Western European investment in the U.S. is, of course, an old story. Its assets in the U.S. were estimated at \$7.2 billion as far back as 1913. At the end of 1958 Western Europe owned 62 per cent of for-

eign direct investment in this country. How much of this investment is owned by the United Kingdom and how much belongs to continental Western Europe has not been determined. An indication of the division can be seen in the fact that the total net flow of direct investment from the United Kingdom to the United States during the 10-year period between 1947 and 1956 was twice that of continental Western Europe to the U.S. At any rate, in view of the important role West European investors have played in the growth of the United States, it is not surprising that they own the bulk of foreign business in this country.

Two-way flow

More surprising is the size and growth of the Canadian share of foreign business in the United States. While Western Europe's share declined seven per cent in the 12 years between 1946 and 1958, Canada's share climbed from 23 per cent in 1946 to 33 per cent in 1956. This 1956 figure represents three-fourths of Canada's total foreign investment. The two-way flow of direct investment between the U.S. and Canada reflects in part their growing economic integration.

Direct investment in the U.S. by countries outside of Western Europe and Canada accounted for a little less than five per cent of the

total in 1958, a fall from eight per cent in 1946. The Latin American republics apparently did not increase their investment at all during this 12-year period.

While no official figures are available, it is clear that the main groups of foreign-owned industries in the U.S. are in finance, manufacturing and petroleum. Numerous foreign banks and insurance companies are actively engaged in business in the United States. Shell Oil Co. is an example of a foreign-owned petroleum industry. Seagram's and Hiram Walker in liquor, the Imperial Tobacco Company, Courtaulds in textiles, Bowater in paper, Phillips in electrical equipment, Lever Brothers in soap and related products, and Imperial Chemical, are some of the manufacturing companies. Most of these businesses are long-established subsidiaries of foreign companies. The number of important new enterprises is relatively small.

Foreign direct investment in the United States since World War II has grown primarily through re-invested earnings, with only a relatively small inflow of capital. New projects frequently are financed largely from financial sources within the U.S. For example, Japanese paper and rayon companies in 1953 organized the Alaska Lumber and Pulp Company, Inc. to tap pulpwood resources in Alaska. In the fall of 1957 the company borrowed

\$19 million in the United States to add to the \$36.5 million of capital raised in Japan. United States portfolio investment in foreign companies can thus be the source of foreign business investment in this country.

Foreign businesses contemplating investment in this country must consider the same general factors which U.S. businesses consider in making their overseas investments. These factors include the size and probable share of the market, the prices at which goods can be sold, the comparative production costs, tariffs, other governmental restrictions on imports, and, finally, the risks which must be run in addition to normal business risks.

But the specific circumstances which attract U.S. investors to Europe are not the same as those which bring foreign investors to this country. U.S. businesses invest abroad in order to compete in local markets, to avoid tariffs and because production costs are lower. On the other hand, foreign businesses don't have to invest here to tap the U.S. market, and they find fewer cases where production costs are lower. While it is understandable that long-established subsidiaries of foreign companies would continue to operate and expand here, the explanation for enterprises investing here for the first time must lie along other lines.

One reason why foreign businesses invest in U.S. facilities is to expedite the sale of their foreign-produced goods. Toyota Motor Company, Ltd., of Japan, for example, is reported to be setting up distribution centers in Chicago, New York, and Miami. It also plans to establish parts depots in Newark, Chicago, and Los Angeles, in order to service the growing number of dealers of its products in the United States.

Similarly, the Olivetti typewriter interests of Italy in 1959 bought a controlling interest in the Underwood typewriter company. This transaction gave Olivetti sales outlets in this country for its adding machines as well as a substantial number of foreign plants. The company may also assemble some of its office machines in Underwood plants here, since in some cases production costs are lower here than in Italy.

Stimulating factors

Other factors stimulating foreign investment here are trademarks and the cross-licensing of patents. Know-how and facilities for cooperative research are also important elements of our business picture which attract foreign investors, especially where mutually beneficial marketing arrangements can be worked out.

The U.S. has another clear advantage as a place in which to in-

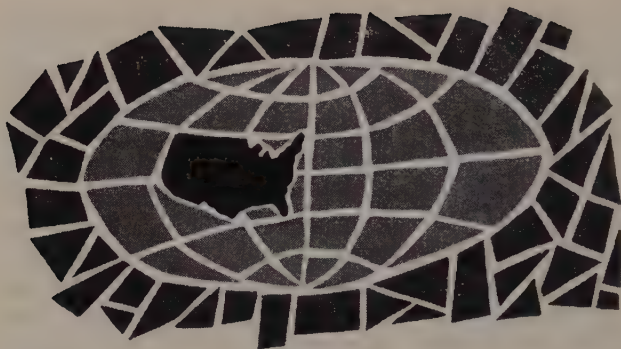
vest. Foreign equity capital must face only the normal business risks in this country. In many less-developed areas such capital may face serious risks of another nature, such as stampeding inflation, political instability and extreme nationalism. Our government is stable. In addition, it has nondiscriminatory laws, an impartial administration of tax and other laws, constitutional limitations on nationalization or expropriation, and requirements for full compensation. Except in time of war there have been no restrictions on moving funds out of the country. No guarantee can be given that a government will never impose such restrictions, but the United States is certainly one of the countries least likely to do so. We do, however, expropriate the assets of enemy aliens, which is an unfavorable factor in the consideration of nonbusiness risks. Whether our antitrust laws prohibiting cartels are "favorable" or "unfavorable"

factors depends on the particular foreign business.

Let us summarize briefly. The bulk of the large volume of foreign-owned assets in the United States is not related to foreign business here. Foreign business investment and operations are, for the most part, a continuation of business established in an earlier period by Western Europe and Canada. Since the inflow of new capital is relatively small, growth of foreign investment in this country takes place largely through re-invested earnings or through portfolio investment by United States financial institutions and other investors. New enterprises are undertaken largely to meet special situations, such as the need to distribute and service the imports of goods produced abroad, or the desire to exchange patents, know-how and marketing facilities with U.S. companies. A minimum of nonbusiness risks here is also a factor in encouraging foreign investment. ■

The Risks of Counterfeiting

A WOULD-BE COUNTERFEITER, who fell for a scheme proposed by shrewder confederates, agreed to furnish \$15,000 in genuine \$100 bills. Ink impressions from the big bills were to be transferred to one-dollar bills that had been previously "bleached out." However, before the transformation could take place, his accomplice left the room with the genuine bills, never to return. Resorting to the law, the counterfeiter attempted to claim a deduction on his federal income tax return for the "uninsured loss." The Tax Court, however, denied him the deduction.



the foreign policy stake

Unless the U.S. can maintain a leading position in the world economy, she will lose her ability to win friends and influence people

by Gardner Patterson

■ PRIOR TO World War II, the United States had faced international payments problems from time to time. But these were usually not very serious, and their non-economic implications were limited because we were not then serving as a world political and military leader.

During World War II and the decade or so immediately thereafter, our exceedingly strong international financial and economic position enabled us to assume the lead in organizing the political and military affairs of the free world, particularly vis-a-vis the Sino-Soviet bloc. During the last few years, our political and military leadership has been challenged from several directions.

Most spectacular have been the

Soviet bloc's scientific and technological advances and their aid programs in underdeveloped areas. A different, but important, test has been posed by our major allies, whose desire and ability to play more prominent roles have grown with their increasing economic strength. The emergence of many newly independent states has reduced the influence in many parts of the world of all the Western nations, including that of the United States.

At the same time that the U.S.A. finds herself confronted with these challenges from all sides, she also is confronted—for an immensely complex set of reasons that have been made clear in the preceding articles in this issue of CHALLENGE—with a new international balance

of payments position. She faces greatly increased competition from other nations in both foreign and domestic markets.

The most publicized measure of this has been the fact that in each year since 1950, except 1957, the rest of the world has accumulated gold and dollars in its transactions with the U.S. Assuming that the conditions responsible for this international financial drain are not entirely transitory ones, what are some of the noneconomic implications for our international affairs of this change from a "dollar shortage" to a "dollar surplus"?

Accumulating thousands upon thousands of tons of gold to bury in Fort Knox was often regarded during the 1930s, when much of it took place, as an act of great folly. Nonetheless, while most people did not appreciate it, this huge gold reserve—which totaled nearly \$25 billion by 1949—gave us such a strong buffer that during World War II and the following decade America was able to formulate her foreign policies without reference to their effect upon her international reserve position. She had more than enough reserves to "pay for" any policy she contemplated, even if the rest of the world should often prefer our gold to our merchandise. This was a freedom that no other major nation, in the West at any rate, has been able to afford in recent times.

The consequence was simple, but important: we were able to consider political, humanitarian and military problems on their own merits. In doing so we adopted a stance of statesmanship that was a surprise to most and the salvation of many.

An examination of Congressional debates or the newspaper editorials of the time show that consideration of Lend Lease, the Marshall Plan, the Berlin airlift, Point Four and NATO was never seriously influenced by our international accounts. Contrast this with the debates on foreign policy in the House of Commons and the British press, the National Assembly and the French press, and the value of our gold reserves to our foreign political affairs becomes apparent.

While our strong international reserve position made it easier for us to *take various foreign policy* decisions, our ability to *make good* on those decisions, insofar as they had economic aspects, depended primarily not on our gold stocks but on the capacity of our economy to provide the goods and services others wanted.

The recent drain on our gold stocks and the build-up of foreign-owned dollar balances has been so dramatic, and such a novel phenomenon for us, that a new and potentially tight constraint has been placed on our decision-making in the field of foreign affairs.

The great danger in our present

situation is that our loss of gold and dollars will be attributed to certain of our major foreign policies, when, in fact, it is the net result of *all* our international transactions. Moreover, whatever the causes of our balance of payments difficulties, it is easier to "do something" about our aid programs or our import policies than it is about our failure to be more successful competitors on the export side—even though this may be the most important cause of our difficulties.

Arguments

The deficit has already led some to conclude that we can no longer "afford" to be as generous in our foreign aid programs as in the past. It is also being argued that our balance of payments problem justifies reducing the cost of our own military installations abroad. While these changes are not necessarily undesirable, even on purely military or political terms, that is not being appraised here. The point at issue is that a newly introduced financial consideration now works against the adoption of foreign policies that *are* supported on non-economic grounds.

It is important that the nature of this financial-economic constraint be clear. With our national income now running at least 50 per cent above the level of the late 1940s, our economic capacity to carry out aid programs and to support our

military efforts abroad should be substantially greater than it was then. But, for reasons analyzed in earlier articles in this issue, the rest of the world as a whole for the past decade has been choosing not to take all the goods and services that our foreign aid, foreign investments and import decisions and policies entitled them to take. Instead, they have chosen to take a part of these in the form of gold and dollars.

In some respects this is an easy way to provide help or to pay for our imports; but exports of gold—and exports of dollar balances are potential claims on gold—do create difficult monetary problems for us. They create, too, psychological problems. It thus becomes easy to conclude that if the rest of the world does not want goods and services we wish to provide under our aid programs, we should stop trying to provide them.

There are many who do not regard the deterioration in our foreign accounts as serious enough to justify the political cost of reducing our aid to others. These people correctly point out that sometimes, however, the countries involved do not take all our help in American goods but instead procure some items from third countries which then accumulate gold or dollars from us. To some this situation justifies tying our aid to purchases in the U.S. and so insuring that

what we want to furnish—namely, merchandise and services made in America—is taken.

In recent years our aid recipients have, in fact, of their own free choice spent much of our aid for goods and services originating here, and some of that spent in the first instance elsewhere was, in turn, quickly spent in the U.S. Our new policy of requiring all such purchases to be made here is unfortunate since it can limit the recipient's ability to make the most economic decision, and it can be expected to have adverse political effects on the rest of the world. It will encourage the belief, always fostered by the Soviet bloc, that the motive behind our aid programs is primarily to help American producers rather than to help our friends improve their economic well-being and their national defense. Acceptance of such views reduces the political benefits we can expect from our help.

Political initiative

In the past quarter century our initiative in lowering import duties and our working for lower trade barriers throughout the world contributed to the willingness of other nations to look to America as a political leader. It was commonly asserted that this policy permitted all nations to enjoy higher standards of living and fostered world peace. Many students have qualified the

first conclusion and severely questioned the second, but it nonetheless has had much appeal to the public and their political officials throughout the world.

Increased foreign competition for American producers and its associated gold losses can be expected to strengthen forces already operating within the U.S. to curtail imports. A reversal of our policy, or even a failure to push ahead much more energetically than we have, will be interpreted by other nations as a turning away from internationalism for a greater degree of self-sufficiency. It will be easier for our critics to convince some of our friends that we are retiring to an isolationist position. This could be disastrous for our national security.

The above considerations are all on the bleak side from the point of view of those who favor the U.S. continuing or enlarging the role she has assumed in world affairs. On a different level of analysis, however, there are some heartening foreign policy implications in our changed international economic position.

Our current foreign trade difficulties stem in large part from the great growth in economic efficiency in recent years of Western Europe, the United Kingdom and Japan. To accomplish just this state of affairs was long at the center of our foreign policy. This greater ability to compete successfully with us

means that these nations are better able to share the burden of helping poorer countries "modernize" their economies. Any such sharing, and especially any enlarging, of the total effort may have a great and favorable impact on the underdeveloped nation's views of the advantages of Western economic practices, institutions and procedures compared with those of the Soviet bloc. The fact that many free nations can help is a much more impressive recommendation for the West than that only one of them can.

Multilateral aid

Moreover, an increase in the ability of our Western allies to help the poorer nations will probably result in more help through multilateral rather than bilateral channels, if only because joint operations make it easier to avoid waste and duplication where several countries are involved. But a multilateral approach can have other advantages too. There is more talent to draw from in developing and executing a program. Any advice or recommendations can be stated in stronger terms. Perhaps the most important advantage is that there will be less occasion to question the motives of those extending help. The Soviet bloc will find it more difficult to convince the public in the recipient countries that the purpose of the West's aid is to

serve the narrow self-interests of the grantor and that secret strings to accomplish this have been attached to the help.

The fact that the U.S., too, now has to consider its foreign policy in the light of its international reserve position should make our officials more understanding than they sometimes have been of others' problems. This, together with the presumed greater confidence and independence that our friends' prosperity and enhanced competitive ability gives them, may well result in the political and military councils of the Western powers becoming more nearly discussions among equals.

Is it naive to hope that in time the results may be not a weakening of our alliances but more carefully and imaginatively developed policies, and ones for which each participant will show greater enthusiasm than during the days when the position of the U.S. was so dominating, if not domineering?

One of the outstanding characteristics of our foreign trade of the last few years has been the increase in our imports, especially of consumer goods. The numbers of European cars on our highways is the most often cited example, but it is by no means limited to them. More important was the rapidly growing amount and variety of imported goods being offered by Montgomery Ward, Sears Roebuck

& Company, and by the thousands upon thousands of small stores.

Public awareness

The American public is becoming much more aware than before of the ways in which our life and economy are intertwined with those of other nations. Only a few, for example, know that most of the chrome seen in the U.S. is imported; but there is no ignorance about the source of Italian sewing machines and Danish furniture. The consequences, doubtless slow in developing, should include some deepening and some broadening of the public's interest in international affairs in general. This could be of great significance because, except in acute international crises, one of the more intractable difficulties faced by Washington in formulating foreign policies has been the massive indifference to foreign affairs of most of the public. Developing an interest in other countries through a much larger flow of imported consumer goods can be an important new asset in

the pursuit of most of our foreign policy objectives.

Finally, one can ask whether our comfortable international economic position in the past has not encouraged too great a reliance on economic devices to accomplish political ends. In the poorer countries, have we given too much attention to increasing the gross national product and not enough to welfare and understanding, and then moulded public attitudes toward political and social organization? In the NATO countries, have we focused so intently on development of a deterrent force that we have not done enough to develop a spirit of cooperation, a sense of direction and political structures consistent with our national defense policies?

If the answer to such questions is yes, then our present less comfortable international position may happily force us to fashion some new, noneconomic instruments and techniques of diplomacy. Then, we may be able to build a stronger foreign policy—one that we can support for a longer period. ■

Answers to Challenge Quiz

(see page 79)

- | | |
|----------------------------------|-----------------------------------|
| (1) False (<i>see page 71</i>) | (6) True (<i>see page 55</i>) |
| (2) True (<i>see page 15</i>) | (7) True (<i>see page 69</i>) |
| (3) True (<i>see page 8</i>) | (8) False (<i>see page 9</i>) |
| (4) True (<i>see page 31</i>) | (9) False (<i>see page 41</i>) |
| (5) True (<i>see page 51</i>) | (10) False (<i>see page 25</i>) |



THE PERMANENT FRONTIER

No. 22: an economic failure, the New Deal did leave the U.S. with an important legacy of social reform

■ **ALTHOUGH** the New Deal revolutionized the role of government in the American economy, it failed, for the most part, to solve the pressing economic crisis of the 1930s. Undoubtedly, New Deal legislation mitigated the depression's effects on many sectors of the economy. But if we use full employment as a criterion of success, the New Deal was a failure. There were still nine million unemployed in 1939.

Despite the assertions of ardent admirers and vehement critics, Franklin D. Roosevelt and his advisors had neither a philosophy nor a program. They were political pragmatists who responded to each problem as it arose. Their reactions to these problems, which evolved as the New Deal, can actually be divided into two main periods: the early New Deal, with its emphasis on economic recovery, and the era which began in late 1934, when the

government became increasingly concerned with broad social welfare legislation.

These concepts did not come easily or according to plan. "The New Deal," observes the historian, Richard Hofstadter, "will never be understood by anyone who looks for a single thread of policy, a far-reaching, far-seeing plan. It was a series of improvisations, many adopted very suddenly, many contradictory. Such unity as it had was in political strategy, not economics."

Except for the establishment of the Tennessee Valley Authority, the first New Deal, shaped in the hectic "Hundred Days" of 1933, emphasized neither compensatory fiscal policy nor broad social welfare. Instead, government inter-

This is the 22nd article of a series in CHALLENGE which deals with the history and development of the United States economy.

vention in this period sought to stabilize and reform the chaotic financial structure, to aid distressed debtors and the unemployed, and to achieve economic recovery without seriously draining government finances.

Financial stability was restored to the tottering banking system through the passage of the Emergency Banking Act, the prohibition of the hoarding and exportation of gold, and the infusion of liberal aid from the Federal Reserve System and the Reconstruction Finance Corporation. The Glass-Steagall Banking Act of 1933 provided for the insurance of bank deposits and separated commercial from investment banking.

After an investigation which revealed widespread malpractices in Wall Street, Congress passed the Securities Exchange Act of 1934. This created the quasi-judicial Securities and Exchange Commission to regulate the securities market.

The government sought to solve the problem of relief for hard-pressed debtors through two important agencies. The Reconstruction Finance Corporation, created by the Hoover Administration, became a crucial loan agency for larger financial and commercial enterprises. The farmers, who were particularly hard-pressed, received aid from the Farm Credit Association and were able to obtain a three-year moratorium on their

mortgage payments under the Frazier-Lemke Act.

Although aid to the unemployed was more substantial than under Hoover, the early New Deal anticipated rapid recovery and therefore rejected long-range, comprehensive plans. Except for the Public Works Administration and the short-lived Civilian Works Administration, major relief projects followed the Hoover program of indirect relief through the states and cities. There was a significant change, however, in the policy of the Federal Emergency Relief Administration, which offered grants rather than loans to the states.

An early New Deal experiment to stimulate economic recovery was the short-lived attempt at mild currency inflation. This was, of course, welcomed by most debtors and was strongly supported by the Western silver mining states. The last attempt at dollar devaluation was in January, 1934, when the government fixed the gold content of the dollar at 59.06 cents. The Administration subsequently gave up the idea of currency inflation as an antidote to the depression.

Of far more significance were the early New Deal's twin instruments of recovery: the National Industrial Recovery Act and the Agricultural Adjustment Act. Both were created with the idea that recovery could come quickly through "planned scarcity."

The AAA reflected the successful pressure of the wealthier farmers in the Farm Bureau Federation and the National Grange. The basic idea of the AAA was to raise farm prices by reducing production. This was achieved through direct government payments to farmers for *not* producing certain crops. The wisdom as well as the effectiveness of this type of legislation became the subject of great national controversy.

Akin to cartels

It was the same with NIRA, even though Franklin Roosevelt called it the "most important and far-reaching legislation ever enacted by the American Congress." Somewhat akin to a government-sponsored system of cartels, the NIRA revolved around the trade association. It emphasized the abolition of "cut-throat competition" and production controls that would limit production to "actual needs." It also guaranteed a minimum wage and maximum hour to workers employed in codified industries. Section 7a, which gave labor unions the right to bargain collectively for the first time, was tacked on as an afterthought.

Factory employment increased quickly as businessmen, in anticipation of a price rise, started production. In the final analysis, however, the NIRA failed to inject broad buying power into the econ-

omy. In 1935 the Act was finally declared unconstitutional by the Supreme Court.

Late in 1934 the emphasis of the New Deal shifted markedly from "recovery through scarcity" to federal legislation of a broad welfare character. Neither the staggering Democratic sweep of Congress in 1934 nor the failure of the NIRA and the AAA to stimulate rapid recovery fully explained this shift. Other more pressing considerations and developments shaped the emergence of the Second New Deal.

After five years of sustained depression, historian William Miller points out, "the coalition of industry, labor, farmers and the government which had marked the critical first New Deal months was breaking under the strain." Powerful sections of the financial and industrial community as well as the press now supported the rabidly anti-New Deal American Liberty League, founded in August, 1934. Trouble for the New Deal also came from organized labor whose leaders now bitterly assailed the administration of the NIRA labor codes.

Moreover, reformers and demagogues like Huey Long, Dr. Francis Townsend and Father Charles Coughlin attracted varying degrees of support. The frustration and despair which resulted from the depression created a fertile ground for such panaceas as Town-

send's pension plan and Huey Long's "share the wealth" utopia.

These new political realities altered the character of the New Deal. Roosevelt turned from the economic nationalism of Raymond Moley to the social welfare notions of Harry Hopkins. The program launched in late 1934 and 1935 was "frankly designed to provide large security and incomes for the masses."

Roosevelt made his new program clear in his annual message to Congress in 1935. He declared:

"We find our population suffering from old inequalities, little changed by past sporadic remedies. In spite of our efforts and in spite of our talk, we have not weeded out the overprivileged, and we have not effectively lifted up the underprivileged."

Reform legislation

The shift in emphasis was plainly reflected in the legislation enacted in 1935. Arthur Link calls it "the most far-reaching program of social and economic legislation in American history." However interpreted, the altered role of government was seen in such major reform legislation as the Wagner Labor Relations Act, the Social Security Act, the Public Utilities Holding Company Act, the Rural Electrification Act and the Revenue Act ("wealth tax"). It was also reflected in the establishment

of the Works Progress Administration (the first systematic program of federal work-relief), the National Youth Administration and the Resettlement Administration, as well as in the establishment of new administrative regulatory agencies and the strengthening of old ones.

Subsequent legislation in the second Roosevelt Administration added to this program. In spite of the divisive consequences of the effort to "reform" the Supreme Court and the emergence of mounting opposition within the Democratic party, these years saw the passage of the National Housing Act and the Fair Labor Standards Act as well as the Second Agricultural Adjustment Act.

Summing up the changing character of reform legislation in these years, Hofstadter has written: "By the end of 1937, it was clear that something had been added to the social base of reformism. The demands of a large and powerful labor movement, coupled with the interests of the unemployed, gave the later New Deal a social-democratic tinge that had never been present in American reform politics."

While the Roosevelt Administration was immersed in social legislation, the sharp recession of 1937-38 suddenly confronted it with the inadequacy of New Deal economic policies in combating the depres-

sion. This recession can be traced in part to the government's reversal of the policies which stimulated the 1936 recovery. This recovery was mainly the result of increased government spending for relief, public works, farm loans and veterans bonuses.

Almost inevitably the consequence of these increased government expenditures was a sharp rise in the national debt. The Administration, which still clung to fiscal orthodoxy, sought to balance the budget to prevent "inflation." Consequently, the Federal Reserve Board tightened credit by raising bank reserve requirements by 50 per cent and the government cut the WPA rolls in half.

As a result, the government's contribution to the gross national product fell by more than \$3 billion, the industrial production index fell from 117 in August, 1937, to 76 in May, 1938, and four million more workers were added to the ranks of the unemployed.

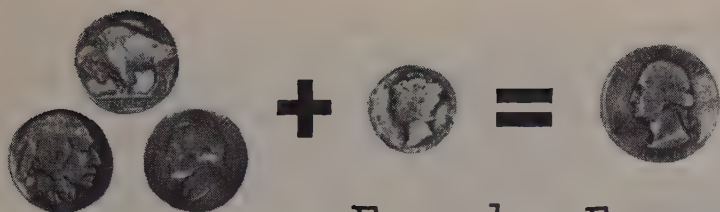
The severity of the recession of 1937 forced the Administration to abandon its fiscal orthodoxy and adopt a compensatory fiscal policy with deficit spending. To justify the increase in government expenditures in April, 1938, the Administration announced that "today's purchasing power. . .is not suffi-

cient to drive the economic system at higher speed. The responsibility of government requires us. . .to supplement the normal processes and. . .to make sure that the addition is adequate." This policy met with strong opposition from influential groups which still believed in fiscal orthodoxy. The idea of compensatory government spending in times of depression has today ceased to be a significant issue in American politics. Both major political parties have now accepted the proposition that deficit spending is an essential part of an anti-deflationary policy.

Walton Hamilton, in *The Politics of Industry*, summed up the essence of the New Deal when he wrote:

"Its policies were expediences improvised to meet the instant emergencies. The instruments employed. . .were, for the most part, temporary in character. The several measures which together bear the name of the New Deal were, to some extent, inconsistent with each other, reflective of changing philosophies, and too miscellaneous a lot to be fitted into a unified and coherent pattern. . . All were fitted out with techniques which were the inventions of the political arts. The great separation of state and economy was gone." ■

NEXT MONTH: World War II



Everyday Economics

■ SOCIAL SECURITY benefits received by a handicapped or elderly person must be counted in determining if someone else contributes more than half of his support. However, the benefits are not counted toward the \$600 income limit on someone claimed as a dependent. Note to new beneficiaries: all types of Social Security benefits are tax exempt but the beneficiary's earnings from a part-time job (or income from investments, real estate, etc.) are still taxable.

Early-bird bargain



THE major trans-Atlantic steamship lines are again offering the 10 per cent discount on round-trip fares during the "off-season" that they discontinued in 1939. The Europe-bound off season ends April 14 but the off season for travelers to the United States continues through June 21. For those who

plan to remain abroad throughout the entire summer, the westbound off season resumes November 1.

Selling out?



A RECENT ruling by tax authorities should interest persons whose residence is a part of their business property. It is no longer necessary to treat the transaction as two separate sales and only an over-all gain on the combined sale is taxable. This could mean tax savings for professional people, farmers and apartment house owners who occupy part of the building.

Partners



A PARTNERSHIP between a professional person and a nonprofessional person is acceptable to the Bureau of Internal Revenue provided that the nonprofessional partner per-

forms an essential role in the business operations. A doctor could, therefore, form a partnership with his wife if she actually manages his office or furnished the capital necessary for setting up his practice. However, if the partnership intends to adopt a fiscal year that does not coincide with the taxable year of the individual partners, the Internal Revenue Service must give its consent before the partnership is formed.

Sunshine insurance



VACATIONS always plagued with bad weather? Several companies specialize in insuring against inclement weather. For every day of bad weather, the policy-holder receives a predetermined payment (usually the cost of his room and board at the resort.) Policies are also available to the promoters of outdoor sports events to help cover the loss of revenue from ticket sales due to inclement weather.

"Bait" advertising



THE Federal Trade Commission warns consumers against the recently outlawed practice of "bait" advertising wherein the customer is lured into the store by the offer of a

popular product at a very low price which the advertiser does not, in truth, want or intend to sell. The advertiser instructs his salesmen to discourage purchases of the advertised product as part of a bait scheme to sell other merchandise. The alert shopper will look out for the following practices which indicate a bait scheme:

- Disparagement by acts or words of the advertised product or its guarantee, credit terms, availability of service, repairs or parts.

- Failure to have a sufficient supply of the merchandise at all outlets, unless the advertisement discloses that supply is limited or available only at certain designated outlets.

- Refusal to take orders for the advertised product to be delivered within a reasonable period of time.

- Delivery of the advertised product which is defective, or impractical for the purpose represented in the advertisement.

Cabaret tax



EFFECTIVE January 1, 1960, packaged liquor bought in a night club is subject to the 20 per cent federal cabaret tax if the buyer was present for any part of the entertainment. The rule applies even if the contents are to be consumed off the premises.—S. T.



Planning for Freedom. Eugene V. Rostow. 437 pp. New Haven: Yale University Press. \$6.00.

•It is a measure of the kind of changes that Rostow's book is concerned with that few readers will regard his title as contradictory. The idea of "planning for freedom" is today so firmly entrenched in the public consciousness that no democratic government could get away with inaction in times of economic crisis on the ground that full employment, price stability and social welfare were none of its business. Rostow rightly regards the general acceptance, within a generation, of government responsibility in these matters as one of the "Great Divides of modern social history." What freedom means in this new context and how it can be strengthened forms the subject of this important book.

As both a distinguished lawyer (he is currently Dean of the Yale Law School) and an equally distinguished economist, Rostow is singularly well qualified for the task he has set himself. While advocating a coordinated monetary and fiscal program designed to sustain the maximum rate of growth consistent with a stable price level, Rostow is too sophisticated a

lawyer not to realize that an enlarged government role does pose a serious *potential* threat to freedom. The courts and our system of statute law can afford us only partial protection against government infringement of individual rights, for law is itself an agent of government.

That is why it is important, Rostow believes, that we retain institutions which are subject to sanctions other than the government. The ultimate justification for the American preference for capitalism "represents more than inertia, inherited loyalties and a belief in its superior efficiency." Rather, it rests "on a recognition of its [capitalism's] role in the strategy of freedom. Unless the . . . opposition can make a living without the permission of the government; unless they can function as a political party, obtain newsprint and presses, hire meeting halls, publish freely; unless they can have access to television without complete dependence on the good will and sporting instincts of the government in power, their opposition is bound to be a feeble, meaningless force existing only by sufferance."

The growing awareness of this fact in Western societies may well be "another Great Divide in modern social history."

New Forces in American Business. Dexter Keezer & Associates. 278 pp. New York: McGraw-Hill. \$4.75.

•Dexter Keezer and his fellow economists at McGraw-Hill are perhaps best known for their remarkably accurate surveys of business spending plans for new plant and equipment. Actually, their mission of interpreting basic economic trends for the business community involves a good deal more. This readable and, for economists, surprisingly unhedged prediction of the business outlook during the 1960s covers, in addition to the investment outlook, discussions of economic growth, inflation, changing markets, our changing foreign trade position and other problems. The discussion on research as an increasingly essential prerequisite for innovation is especially interesting. What is said in some of the other chapters has admittedly been said before, although not as clearly. Dr. Keezer's optimism (especially his discussion of our prospective position in the world economy) would probably not be shared by his more cautious academic colleagues. On the other hand, it is difficult to put down this book without sharing his belief in the basic dynamism of the U.S. economy.

* * *

Nehru, the Years of Power. Vincent Sheean. 298 pp. New York: Random House. \$5.00.

•Written with warmth, clarity and perception, this is a fascinating study not only of Nehru, but of past and present India as well.

Sheean is convincing in his discussion of why India's domestic poli-

cies are as they are; he is less so in foreign policy.

While few would agree completely with Sheean that Nehru "appears to be the only chief of government anywhere at present who has a genuine world view," fewer would dispute Sheean's conclusion that Nehru, a man of wisdom, can alone provide the strength of leadership needed by the largest and most complex nation in the non-Communist world.

* * *

Pension Funds and Economic Power. Paul P. Harbrecht, S.J. 328 pp. New York: The Twentieth Century Fund. \$5.00.

•Father Harbrecht has written a good book on an important subject. Assets of private pension and retirement funds currently stand at \$33 billion—and they are growing at the rate of \$4 billion a year.

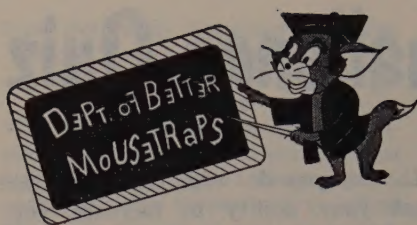
While Father Harbrecht's remarkably illuminating study analyzes how these vast sums are being administered, he is more interested in some of the broader "political" implications of pension funds. Who "owns" such funds? Quite apart from the fact that, in Father Harbrecht's opinion, pension funds inadequately safeguard the rights of beneficiaries, he is concerned over the fact that those who manage them are, both in fact and often in law, responsible to no one. Such funds, moreover, are neither "private" nor "public," answerable neither to the direct control of beneficiaries, unions or corporations, or of public bodies. At the same time, the manner in which these vast sums are invested exerts a profound effect on the nation's capital markets. ■



Challenge Quiz

HOW WELL can you do with this true-false quiz? Test your ability to increase your knowledge through reading. Ten correct answers is Excellent; 9, Good; 8, Average. If you do the quiz *before* reading the articles, 6 correct answers is good. Answers on page 69.

- (1) The Banking Act of 1935 provided for the insurance of bank deposits and separated commercial from investment banking.
True ☐ False ☐
- (2) U.S. gold holdings have dropped to under \$20 billion, \$12 billion of which is required to cover the amount of money in circulation.
True ☐ False ☐
- (3) The cost of U.S. troop maintenance overseas runs to approximately \$3.4 billion annually.
True ☐ False ☐
- (4) Between 1953 and 1958, U.S. industrial exports rose by 20 per cent while Italy's rose over 63 per cent.
True ☐ False ☐
- (5) The European Free Trade Association was formed under the leadership of the United Kingdom.
True ☐ False ☐
- (6) From 1954 to 1957 countries with annual per capita incomes of less than \$100 did not get as much international economic aid as countries with higher per capita incomes.
True ☐ False ☐
- (7) Most of the chrome used by American manufacturers is imported.
True ☐ False ☐
- (8) The United States gold reserve currently comprises one-quarter of the monetary gold stocks of the free world.
True ☐ False ☐
- (9) At the present time, average life expectancy in India is 45 years.
True ☐ False ☐
- (10) In the United States, merchandise imports exceeded merchandise exports for the first time in 1958.
True ☐ False ☐



Behind the Wheel: Winter driving kit that contains everything necessary to cope with the problems of snow and ice. Included are: shovel, steel traction mats, windshield scraper and brush.

* * *

The Home Workman: Permanent sandpaper for use with hand or power sanders is suitable for use on wood, plastics or composition materials. The abrasive consists of tungsten carbide particles bonded to steel so that they cannot rub off or wear out. When the sheets cake up they can be cleaned by rubbing with a wire brush. .Sawhorse brackets that make it possible to assemble a horse without using nails, screws or miter cuts. All that is necessary are the brackets and some 2" x 4" lumber. .Plastic tape for sealing threaded pipe joints; it is unaffected by extreme temperatures, acids, alkalis or solvents and does not harden after application, permitting easy disassembly. .Plywood-plastic paneling for use on walls, counters, etc., that is only one-quarter inch thick. Already bonded, the paneling is easy to handle and saw, and neither temperature nor moisture will cause it to buckle.

* * *

Children's Corner: Competitive car racing game for two players that provides the thrills of real driving. The players use steering wheels to

guide the cars over the fibreboard course. Hidden magnets attached to the steering mechanism move along the road, guiding cars. .Home planetarium projects 60 constellations on the walls or ceiling of a dark room. The planetarium can be adjusted for any location in the Northern Hemisphere and is available in battery-operated or plug-in models.

* * *

In the Kitchen: Plastic butter ruler with raised markings indicating cup, tablespoon and teaspoon measurements. When the ruler is pressed against a stick of butter the markings become imprinted on the surface. .Bacon grill made of perforated aluminum inserts into the skillet, to permit grease to drain into the skillet, leaving the bacon dry and crisp. .Automatic defroster for refrigerators will fit all types; plugs into wall outlet and operates noiselessly. .Quart-size syphon that makes sparkling club soda for one person or for a dozen from ordinary tap water. It can also be used to make fizzy, flavored soda drinks from home recipes.

* * *

Around the House: Crystal-clear heavy plastic tissue holder shows the remaining tissue supply. It has a floating lid with a circular "pop-up" opening to assure that the next tissue will be at hand without groping inside the container. .Drain cleaner that attaches to the faucet and drain and with hydraulic pressure clears the most stubborn clogged drain rapidly. The cleaner has no moving parts and is available with extension tube for cleaning tubs, showers, etc.

* * *

Write to CHALLENGE magazine for additional information. ■